Government of Canada Gouvernement du Canada

REPORT ON THE STUDY OF THE ACCOUNTS OF CANADA

OCTOBER 7, 1975

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Treasury Board Conseil du Trésor

October 7, 1975.

Mr. T.K. Shoyama,
Deputy Minister,
Department of Finance,
Ottawa, Ontario.
K1A 0G5

Dear Sir:

Steering (
and practi
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are set ou

Ottawa, Ontario
K1A 0R5

Treasury Board Conseil du Trésor

October 7, 1975.

Mr. J.L. Fry,
Deputy Minister of Services,
Department of Supply and Services,
Ottawa, Ontario.
K1A 0T5

Dear Sir:

Steering
and pract
The terms
are set o

Ottawa, Ontario
K1A 0R5

Treasury Board Conseil du Trésor

October 7, 1975.

Mr. G.F. Osbaldeston,
Secretary,
Treasury Board,
Ottawa, Ontario.
K1A 0R5

Dear Sir:

Re: Study of the Accounts of Canada

We take pleasure in enclosing the final report of the Steering Committee which has been studying the purposes, principles and practices which should govern the form of the accounts of Canada. The terms of reference for this study, as approved by Treasury Board, are set out in the Introduction to our report.

Yours very truly,

N. Glenn Ross — Chairman

S.J. Handfield-Jones — Department of Finance

A.G. Irvine — Department of Supply & Services

L.M. McGimpsey — Treasury Board

Ottawa, Ontario
K1A 0R5

EXHIBITS

SUMMARY

The attached report sets forth the findings, analysis and recommendations which have resulted from the Study of the Accounts of Canada conducted by representatives of Treasury Board, the Department of Finance, and the Department of Supply and Services under terms of reference approved by Treasury Board.

The following summarizes the content of the report by chapters and sets forth the recommendations contained therein.

Introduction

The introduction to the report examines the various purposes served by the accounts of Canada, and briefly describes the concepts and practices on which the accounts are now based. It draws specific attention to the fact that those areas raised in the 1973 Report of the Auditor General, where the Secretary of the Treasury Board has indicated by letter to the Public Accounts Committee that the matters would be studied, are referred to at appropriate places in the report, normally in the concluding sections of each chapter.

Chapter 1 -

Definition of the Government of Canada for purposes of financial reporting

This chapter considers how the Government of Canada should be defined for purposes of the financial reports of Canada for which there is now a statutory requirement. Arguments are put forward against a comprehensive definition which would include all corporations controlled

by the government, and against the more minor change of including the five Schedule C corporations which now use the Consolidated Revenue Fund for banking purposes. The report recommends continuation of present practices.

Recommendation 1 - *The Government of Canada should continue to be defined as consisting of all the departments named in Schedule A of the Financial Administration Act; any other division or branch of the Public Service of Canada, including a commission appointed under the Inquiries Act designated by the Governor in Council as a department for purposes of the Act; the staffs of the Senate, the House of Commons and the Library of Parliament; and, any corporation named in Schedule B of the Financial Administration Act.*

This does not mean that there will be no change in accounting practices. Under the concept of an accounting entity all balances and transactions among components of the entity should be eliminated in order to present the financial statements in terms of relations with third parties outside the accounting entity. To achieve this effect the report recommends that all appropriations, other than those affecting financial claims owing by or to third parties, should be treated as budgetary, thereby eliminating any balances from the Statement of Assets and Liabilities.

Recommendation 2 - *Expenditures under all appropriations granted to departments and agencies falling within the limits defined for the Government of Canada should be accounted for as budgetary, except where they give rise to financial claims, or reduce financial claims due by or to organizations and individuals outside of the entity so defined.*

Chapter 2 -

Statements of financial transactions

The report identifies a variety of statements now issued that report on transactions crossing the Consolidated Revenue Fund, including the Budget Speech and the monthly statements. It suggests standard statements setting forth transactions under four main headings: budgetary transactions, non-budgetary transactions, foreign exchange transactions, and unmatured debt transactions.

Recommendation 3 - *In those publications presenting summary statements of the Government of Canada's financial transactions, a standard form of presentation should be utilized.*

For analytical purposes the report proposes one additional monthly statement for the month of March, and also that the same standard monthly presentation for the period subsequent to the year-end should be included with the "Preliminary Financial Statements for the Fiscal Year".

Recommendation 4 - *The current practice of publishing a statement of government financial operations through the Canada Gazette should be extended to cover separately the month of March. In the "Preliminary Financial Statements for the Fiscal Year" a standard set of tables for the supplementary period after the fiscal year-end should be included, as well as the present tables providing a preliminary statement of assets and liabilities and net debt position.*

The report also proposes modifications to the statements prepared on a National Accounts basis which are now included in these various publications. This is to provide for transactions not now included so that both sets of statements will account in full for changes in the government's cash balances.

Recommendation 5 - *The current practice of displaying the government's transactions in a National Accounts framework for revenues and expenditures should be extended to include loans and other transactions to third parties so as to display the total financial requirements of the government for any given period.*

Recommendation 6 - *The publication of government financial operations through the Budget Speech, the Public Accounts and the Canada Gazette should be expanded to include the presentation of transactions on an Extended National Accounts basis including reconciliations where appropriate.*

Chapter 3 -

Presentation of summary information in Estimates

This chapter makes a number of proposals to improve the nature of the data included in the Estimates, and its comparability between years. Essentially, the report proposes that a distinction be drawn between "estimates of expenditure" and "amounts to be voted", and proposes revised summary presentations to make more clear the comparisons between years of these two types of data. In addition, it is proposed that estimates of expenditures under all multi-year and continuing authorities, whether budgetary or loans, investments and advances, should be included in the Estimates. An improved summary table for Supplementary Estimates is also proposed.

Recommendation 7 - *For both budgetary appropriations and non-budgetary loans, investments and advances, the amounts presented in summary tables in the Estimates book for the Estimates year should show, as required, amounts to be voted separately from estimates of expenditures. Estimates*

of expenditures should show amounts expected to be expended not only under annual and statutory authorities as at present, but also the net amounts required or provided under fund and other multi-year authorities not now included.

Recommendation 8 - *Tables 1 and 2 providing summary data in the front of the Main Estimates book should be revised to show amounts to be voted separately from estimates of expenditure and to show prior year data in a manner that draws more appropriate comparisons with each of these amounts for the Estimates year.*

Recommendation 9 - *The summary table in Supplementary Estimates presentations should be revised to present new proposals in terms of both amounts to be voted and estimates of expenditures, and to bring forward and arrive at totals for each of these two amounts, with budgetary appropriations and non-budgetary loans, investments and advances being separately summarized.*

Chapter 4 -

Statement of Assets and Liabilities

This chapter acknowledges that the present description in the Public Accounts of the accounting practices followed in preparing this Statement no longer properly expresses the policy followed. It proposes to define assets and liabilities as referring to financial claims due by or to third parties outside the Government of Canada.

Recommendation 10 - *Assets and liabilities of the Government of Canada should be defined as follows:*

- *assets are the financial claims acquired by the Government of Canada on outside organizations and individuals as a result of events and transactions prior to the accounting date; and*

- *liabilities are its financial obligations to outside organizations and individuals as a result of events and transactions prior to the accounting date.*

The report next examines the various social security accounts which have been treated as non-budgetary, any balances thus being carried on the Statement of Assets and Liabilities. The position taken is that only balances contributed by or due from third parties as a result of special funding should be reported on the Statement. On this basis, the action already taken to change the treatment of the Old Age Security Fund is acknowledged. The major change proposed is that the government record its liability to the Unemployment Insurance Account as a budgetary expenditure on a current basis. An exception to the financial claims definition is recognized in respect of the Superannuation Accounts where actuarial deficiencies are amortized over a five-year period. This practice, while not in keeping with the general approach proposed for the Statement, results in a more appropriate year-to-year recognition of the government's costs.

Recommendation 11 - *The Unemployment Insurance Commission should be reimbursed by the government on a monthly basis for all expenditures to be borne by the government. Such reimbursements should be recorded as budgetary expenditures of the period to which they pertain, thus deleting non-interest-bearing advances from the Statement of Assets and Liabilities.*

The report also examines other balances not meeting the defined policy for the Statement of Assets and Liabilities, and a recommendation is put forward to eliminate certain items.

Recommendation 12 - *Consistent with the definition of assets and liabilities previously recommended, the following should be deleted from the Statement of Assets and Liabilities:*

- *working capital advances and revolving funds except for those primarily used to record financial claims on organizations and individuals outside the Government of Canada;*

- *undisbursed balances of appropriations to special accounts; and*

- *deferred loan amortization costs and premiums.*

The report examines various assets and liabilities not reported on the Statement, of which capital assets and inventories are the most significant. Problems of valuation, as well as reporting considerations, suggest against any change from the present practice of not recording them on the Statement. Under proposals put forward later, fund appropriations can be used to finance these assets and thereby obtain the same accounting benefits without any distortion of the government's summary accounts.

This chapter next considers the very significant problems of valuing financial claims. In principle, it is recognized that these should be valued as close to their current economic value as it is possible to determine objectively. This should be done preferably by revaluing specific assets, or failing that by provisions to establish reserves against a class of assets or liabilities. In either case, the

offsetting entry should be made to budgetary expenditure or revenue, as the case may be, except in those rare circumstances where a major change in valuation policy is being implemented.

The report considers valuation problems involving claims other than those owing by Crown corporations controlled by the government and concludes that valuation adjustments or provisions should be made wherever there are contingent forgiveness clauses, or past experience on which to base the valuation adjustments. Valuation adjustments of loans to other governments are rejected, recognizing that changes in such values are normally matters of negotiation. Present value computation of interest-earning assets is also rejected on the basis that this would be of little benefit, would create a need to value unmatured debt on the same basis, and would be inconsistent with normal practices in accounting for debt costs.

> Recommendation 13 - *Reserves should be established against specific classes of domestic loans and advances to reflect conditional forgiveness clauses, and in the case of loans and advances to non-governmental organizations or to individuals, amounts required to provide for that portion of the total loans, which based on past experience, are not likely to be repaid.*

The matter of valuation is more complex when it comes to government-controlled corporations. The legal form of an investment is not of great significance when the borrower is controlled. Because of the enormous complexities of seeking to value such organizations at current economic values, the report does not favour departing from the cost basis of carrying such claims. When the capital structure of the corporation itself is restated, however, the government's investment

should also be restated to provide a realistic base against which to measure future operations.

Specific proposals are not submitted in connection with the foreign exchange accounts, because it is recognized that the subject is being reviewed elsewhere and that a valuation formula is likely to be proposed that is consistent with the practices proposed in this report.

This leaves outstanding the matter of the treatment of the existing reserve for losses on realization of assets. The report concludes that there is little reason to leave the present balance, which has been arbitrarily established, or to add to it further arbitrarily computed amounts. On balance, it is concluded that after providing for any specific valuation adjustments and reserves, any balance should be written off to the account recording the excess of recorded liabilities over recorded assets as an offset to the other adjustments that will be required as a result of this report.

Recommendation 14 - *The present reserve for losses on realization of assets should be used to provide for any specific reserves that may be required, with any balance being written off after arriving at the budgetary surplus or deficit of the year, along with such other adjustments that may be required at the time of implementation of proposals in this report.*

The chapter concludes with a number of proposals to improve the presentation of the Statement, together with an illustration of an improved presentation.

Recommendation 15 - *The following changes should be made to the presentation of the Statement of Assets and Liabilities:*

- *all internally held indebtedness of the Government of Canada should be shown as a reduction of the government's liabilities, not as assets of the Government of Canada;*

- *similar types of outstanding payment instruments should be reported together;*

- *deferred credits should be deducted from domestic and external advances, loans and investments, because they have the nature of a reserve against these claims;*

- *assets due from and liabilities due to Crown corporations which primarily engage in banking, lending and insurance activities should be shown separately from those relating to other Crown corporations;*

- *assets and liabilities should be grouped in a manner which makes it easy to relate to changes in cash flows;*

- *certain assets, such as deferred charges, should be offset against liabilities to which they relate; and*

- *certain foreign assets and liabilities should be grouped separately.*

Chapter 5 -

Statement of Expenditure and Revenue

This chapter is solely concerned with matters of financial statement presentation. Two matters, which are closely allied, are considered. The first concerns the presentation of both gross and net expenditures of those appropriations permitted to expend revenues, and

the second concerns the elimination of inter and intra-departmental transactions. A proposed presentation is illustrated which shows both gross and net expenditures, and which eliminates transactions not with third parties. The latter proposal is in keeping with the concept of an accounting entity.

Recommendation 16 - *The Statement of Expenditure and Revenue should be prepared in a manner which shows expenditures and revenues on both a gross and net basis so that the net amounts are stated consistently with the manner in which amounts are presented in the Estimates. These and other interdepartmental transactions and transactions between appropriations of a department should be deducted to arrive at revenues and expenditures involving third parties.*

Chapter 6 -

Accounting for Revenue

This chapter examines three closely related matters: first, the difficulties in determining tax revenue; second the problems encountered in recording the receipt of revenue; and finally, the cash basis of reporting revenue in the accounts of Canada.

Recommendation 17 - *The possibility should be fully explored of identifying more accurately contributions to the Canada Pension Plan and Unemployment Insurance accounts, and of analysing them with a view to improving on present estimates of amounts credited to these accounts from current collections.*

Recommendation 18 - *Tax and non-tax revenue should continue to be reported on a cash basis on the Statement of Expenditure and Revenue.*

Chapter 7 -

Accounting for appropriations other than fund appropriations

This chapter is concerned with a number of complex and controversial issues which affect the manner in which appropriation authority is granted by Parliament, and the manner in which it is presented in the Estimates and reported in the Public Accounts.

Consistent with proposals put forward for presenting and summarizing data in the Estimates in Chapter 3, this chapter proposes that a clearer distinction be drawn between amounts to be voted and estimates of expenditure in the detailed presentation of appropriations, and that appropriations not now included in the Estimates be included, together with the necessary supporting information, in order to provide complete information on all budgetary appropriations and non-budgetary loans, investments and advances. It is also proposed that the Public Accounts provide a complete reporting of all budgetary appropriations and all non-budgetary loans, investments and advances to show comparisons of actual expenditures with estimates of expenditures included in the Estimates.

> Recommendation 19 - *The Estimates book should include estimates of expenditure under all non-budgetary loans, investments and advances appropriations and the Public Accounts should show a comparison of actual expenditures with estimates of expenditures forecast for all appropriations included in the Estimates.*

The next matter examined in this chapter concerns the structure of appropriations. While the format is program oriented it is recognized that most program data are really a reconstitution of organizational data, or else organizational expenditures allocated in a very approximate

manner. The report recognizes the difficulties of obtaining more precise program costing, and recommends that the cost components be precisely enough defined so that cost data presented in the Public Accounts are stated consistently with the Estimates.

Recommendation 20 - *Appropriations should be structured on a program basis which best explains the purposes for which funds are to be expended, and the amounts attributed to each program should be defined precisely enough to ensure that expenditures can be accounted for in the Public Accounts in a manner consistent with that used in preparing the Estimates.*

Parliament normally appropriates funds for expenditures on a gross basis, but in a number of instances, authority has been granted to credit revenues to appropriations, and thus in these instances the appropriations are stated on a net basis. The report indicates that most departments having this authority neither account for nor manage their programs in detail on a net basis, and that the revenue serves mainly to provide a means of financing unforeseen expenditures. The managerial incentives that were the chief justification for the practice appear not to have been realized. Thus, the report concludes that the practice should be discontinued, except for purposes of allocation of costs between programs and departments. In this area, it is recommended that only direct incremental costs be recovered.

Recommendation 21 - *Net voting of revenues derived from outside the Government of Canada should be discontinued.*

Recommendation 22 - *Amounts recovered from other appropriations should continue to be net voted but such recoveries should be restricted to incremental expenditures.*

The term of appropriations is the next matter examined. Annually lapsing appropriations serve Parliament's need for an annual opportunity to challenge governmental appropriations, but there are a variety of forms of exceptions. The report endorses only two - statutory appropriations where the amounts and criteria for payment are so clearly spelled out that an annual limit on expenditures is not necessary, and non-budgetary appropriations where there is a limit on advances that may be outstanding at any one time.

Recommendation 23 - *Annually lapsing authority should be granted wherever possible and time limits should be removed only where the purposes and the criteria for the determination of individual transactions are clearly specified in appropriate statutes, or where in the case of loans, investments and advances a limit is imposed on the amounts that may be outstanding at any point in time.*

The report then examines the several modifications to the cash basis of accounting for expenditures which now exist. It proposes that the present permissive 30-day rule for settling expenditures coming in course of payment during a fiscal year be changed to make recording of expenditures mandatory, even where the appropriation limit is exceeded, with accounts payable exceeding the appropriation limit being charged against the subsequent year's appropriation when paid. This will result in the year's expenditures being stated more correctly, will expedite the closing of the accounts, and will maintain a sanction on those departments whose expenditures exceed their appropriations in that they will be required to offset excesses in the subsequent year.

Recommendation 24 - *The Financial Administration Act should be amended to require all expenditures under annually lapsing appropriations coming in course of payment during the fiscal year to be so recorded even if this results in expenditures in excess of the appropriation authority, with disbursements to discharge such accounts being charged against the subsequent year's authority where the current year's authority is exceeded.*

This chapter concludes by examining the accounting for commitments. Various acceptable and unacceptable definitions of commitments are examined, and a definition is proposed. The question of having expenditure and commitment authorities exactly the same is then examined, as well as the need for limits on commitments applicable to succeeding years.

Recommendation 25 - *For purposes of applying the statutory requirement to maintain a record of commitments:*

- *a commitment should be defined in the Financial Administration Act as an obligation to make payment from an appropriation of a current or subsequent year, an obligation which arises when an agreement is made in good faith with other parties;*

- *commitments should include:*

  (a) specific commitments which are discharged as a result of a single action or set of actions, and

  (b) continuing commitments which are discharged by a series of actions which are expected to continue for an indeterminate period of time;

- *intentions to enter into obligations should not be included within the definition of commitments; and*

- *the creation of budgetary sub-allotments should not be regarded as superseding the requirement to keep a record of commitments within each such sub-allotment.*

Recommendation 26 - *Where there is a significant degree of uncertainty as to whether other parties will fulfill the conditions necessary for commitments to materialize, and there is need for commitment authority in excess of the amount of the appropriation, such commitment authority should be provided in the vote wording.*

Recommendation 27 - *The practice of imposing constraints through the vote wording on a department's ability to enter into commitments payable in future years should be extended wherever a significant amount of specific commitments payable in future years are normally outstanding, but the vote wording should clearly indicate that this does not free the department from the constraint on current year's commitments imposed by the amount of the annual appropriation.*

Chapter 8 -

Accounting for fund appropriations

This chapter refers to revolving fund, working capital advance and similar non-lapsing, net and non-budgetary appropriations now granted to finance portions of departmental operations. The report recognizes an existing confusion in terminology, and suggests a single term "revolving

fund" be used in the future. At the same time it is suggested that funds used to finance loans to third parties be redesignated as loan accounts and continue to be treated in accordance with present practices since they meet the test of being financial claims.

Recommendation 28 - *The present distinction between revolving funds, working capital advances, and similar accounts should be eliminated with the title revolving fund being used in new authorities and where generic headings are required in the accounts of Canada to group all such accounts.*

Recommendation 29 - *Funds used to finance loans or advances outside the defined limits of the Government of Canada should be redesignated as loan accounts.*

The report recognizes that the present non-budgetary treatment of these appropriations is probably the key to most of the accounting problems concerning them since this leads to a diametrically different accounting treatment on the summary statements of Canada. Therefore a change in this treatment is proposed.

Recommendation 30 - *Appropriations for revolving funds, working capital advances and similar accounts should be classified as budgetary.*

Recommendation 31 - *The net amounts advanced out of the Consolidated Revenue Fund for purposes authorized under fund appropriations should continue to be recorded in the accounts of each fund, until authority is obtained from Parliament to delete all or a portion of the amounts advanced.*

The report concludes that the revolving and continuing nature of these appropriation authorities is warranted only where there is a long-term relationship between receipts and expenditures which warrants multi-year or continuing accountability.

Recommendation 32 - *Where receipts are likely to offset expenditures over the long-term, authority should be granted on a continuing basis, by means of fund appropriations, to make advances from the Consolidated Revenue Fund and to spend receipts.*

The report next examines the nature of the operations and the costs that should be financed through funds and concludes that there is a degree of overlapping with annual appropriations in the case of some of the purposes for which they are now used. Others are so small relative to the annual appropriations of the same departments that they are of limited value. Finally, the report examines the practice of providing authority separately for capital, and concludes that a single authority provides better accountability. It is suggested that any limits that Parliament may wish to impose on annual capital expenditures should be through a limit on annual expenditures contained in the wording of the authority.

Recommendation 33 - *Funds should be used in lieu of annual appropriations only where the operations they finance can be clearly distinguished from those financed through other appropriations, and where the magnitude of the operations, relative to the other appropriations of the department, warrant such separate authority.*

Recommendation 34 - *The authority for each fund should cover the financing of working capital, capital and operations, with the wording of the authority imposing a limit on the*

amount of expenditures for capital purposes in a single fiscal year only in those circumstances where Parliament considers this to be necessary.

The report next examines reporting practices in both the Estimates and Public Accounts and suggests an improved presentation which will account for amounts advanced out of the Consolidated Revenue Fund during the year in terms of operations, capital and working capital requirements and in terms of objects of expenditure, the latter to permit economic analysis of expenditures through funds in the same manner as expenditures through normal appropriations.

Recommendation 35 - *Estimates of both operating and capital expenditures for each fund should be included in the Estimates as budgetary expenditures supported by a schedule which shows expenditures and revenues from operations, depreciation, capital assets and changes in working capital, and by a note which relates estimated advances outstanding for each of these purposes to the authority limit.*

Recommendation 36 - *The Public Accounts should include the following statements for each fund:*

- *a balance sheet;*
- *a reconciliation of differences, if any, between net amounts advanced from the Consolidated Revenue Fund and net advances as recorded on the statement of the individual funds;*
- *a statement of operations;*

- *a statement of changes in advances which shows operating results, depreciation, expenditures on capital assets, and changes in working capital;*

- *a statement of gross receipts and expenditures, with expenditures classified by objects and receipts by sources;*

the three latter statements showing comparisons with amounts included in Estimates.

The chapter concludes by examining a number of accounting practices.

Recommendation 37 - *Expenditures to be financed through each fund should be determined in a manner consistent with those used in computing normal appropriations.*

Recommendation 38 - *Each fund should keep its accounts:*

- *on an accrual basis so that expenditures can be related to revenues and assets made subject to good accounting control; and*

- *on a modified cash basis so that information equivalent to that required of other appropriations can be obtained for purposes of aggregation and analysis with the other accounts of Canada.*

Recommendation 39 - *The year-end procedures for accounting for amounts advanced during the year to funds should be applied in the same manner as for other budgetary appropriations and should include amounts required to discharge*

debts payable for work performed, goods received or services rendered prior to the end of the fiscal year.

Chapter 9 -

Accounting for government enterprises

The last chapter of the report is primarily concerned with the accounting for those corporations classified under Schedules C and D to the Financial Administration Act. These corporations are excluded from the definition of the Government of Canada in Chapter 2 because they are quasi-commercial in nature and because government accounting practices are not appropriate for them. This chapter examines their budgeting and financial reporting practices.

The chapter first examines the practice of Crown corporations in submitting budgetary information to the government and concludes that greater authority should be granted to the Governor in Council to prescribe budgetary practices.

Recommendation 40 - *The Financial Administration Act should be amended to authorize the Governor in Council on the recommendation of the Treasury Board to prescribe for Crown corporations classified under Schedules C and D:*

- *definitions of each type of budget to be submitted;*

- *the format, content, period and basis of preparation of each type of budget as well as the manner and timing of submissions;*

- *conditions for the submission of revised budgets; and*

- *conditions governing the approval of a capital budget which provide only for approval in principle of the projects or categories shown therein, the commitments associated with them and the cash expenditure ceilings shown for the budget year, and which stipulate that approval in principle of the level of spending of budgets is conditional upon funds becoming available as indicated in the budget.*

The chapter examines procedures governing the published financial statements of Crown corporations. A number of deficiencies in comparison with generally accepted practices for commercial enterprises are recognized. It is proposed that authority be granted so that reporting requirements can be prescribed by means of regulations.

Recommendation 41 - *The Financial Administration Act should be amended so that regulations may be issued in respect of the accounts and financial statements of Schedules C and D Crown corporations, and subsidiaries thereof, providing for:*

- *separate disclosure on financial statements for each area of program accountability and for each parliamentary authorization;*

- *disclosure of transactions between the government and a corporation, and between government-owned corporations, arising from grants, contributions, loans, interest and similar transactions;*

- *issue of a statement of source and application of funds;*

- *issue of quarterly interim statements;*

- *creation of reserves; and*

- *such other matters as are required for purposes of consistent and adequate disclosure of their financial affairs.*

Finally, the report examines the need to make the accounts of Canada complete by including in the Public Accounts the published financial statements of all Crown corporations.

INTRODUCTION

TERMS OF REFERENCE OF THE STUDY

The terms of reference for the Study of the Accounts of Canada, as approved by Treasury Board, read as follows:

> "To study the purposes, principles and practices which should govern the form of the accounts of Canada, taking into account the practices of other governments, including
>
> - the concept of a single consolidated fund,
> - the use of revolving funds, working capital advances and other special accounts,
> - the cash or modified cash basis of accounting,
> - the annual basis of most parliamentary appropriations, including the need for any limitation on commitments applicable to future years,
> - the vote structure, including the effect of allocation of costs between votes, cost recovery techniques and net voting,
> - accounting for assets and liabilities,
> - accounting for non-budgetary transactions,
>
> and such other matters as affect the fairness, completeness and accuracy of the information provided in the accounts."

While the preamble to these terms of reference is broadly stated, emphasis is given in this report to the matters specifically identified. The proposals put forward seek to satisfy the needs of the various users of the accounts of Canada - Parliament and its Standing Committee on Public Accounts, the government, the Auditor General of Canada, management in departments and agencies, and members of the public who either because of their special interests or as citizens of Canada wish to have details on the Government of Canada's finances. This report seeks to provide both a logical, conceptual framework for the accounts of Canada and courses of accounting action which will resolve in a manner acceptable to all users of the accounts of Canada the various matters that have been specifically identified in the terms of reference.

Accounting is concerned with recording and analysing economic and financial transactions in a manner which facilitiates the communication of significant matters. Both those who prepare financial statements and those who use the information derived from them must understand the rules and practices that underlie the accounts if there is to be effective communication.

The term "accounts of Canada" has been interpreted for purposes of this study as referring primarily to the financial reports derived from the accounting and other financial records of the Government of Canada. As such, the report is concerned with the practices which govern the Public Accounts, and which also have impact on the other reports falling within the responsibility of Treasury Board, the Minister of Finance and the Receiver General. These include the Estimates and the Budget, which convey information on planned financial transactions, and the monthly Statement of Financial Operations.

Additional information is contained in financial reports issued by departments, agencies and Crown corporations, and in their internal systems of management reports. While all these financial

reports have not been comprehensively analysed, recommendations are submitted to encourage greater consistency of reporting where the information being reported is the same as that contained in the Estimates and Public Accounts, and to encourage greater integration where much of the information is derived from the accounts of Canada but is based on different concepts or practices.

Recommendations are submitted proposing a limited number of changes in the format of the Estimates, the Statement of Assets and Liabilities, and the Statement of Expenditure and Revenue, and proposals are made for a Statement of Financial Transactions. Exhibits are provided to illustrate the nature of the recommendations, but the detail on these exhibits should be regarded as only illustrative of the kind of information and the nature of the presentation. Alternative or simpler changes might be substituted in the course of implementation. In addition, it is important to note that there has not been any study of the detailed information contained in the Estimates and the Public Accounts.

STATUTORY RESPONSIBILITIES FOR ACCOUNTS OF CANADA

Before examining the purposes, principles and practices used in maintaining the accounts of Canada, it might be useful to summarize the manner in which Parliament now assigns responsibility for accounting and reporting. The Financial Administration Act is the means through which statutory responsibility is assigned.

The Financial Administration Act assigns responsibility to Treasury Board in the following sections:

> 5. "(1) The Treasury Board may act for the Queen's Privy Council for Canada on all matters relating to...
>
> (c) financial management, including estimates, expenditures, financial commitments, accounts, fees or charges for the provision of services or the use of facilities, rentals, licences, leases, revenues from the disposition of property, and procedures by which departments manage, record and account for revenues received or receivable from any source whatever;...

> (4) The Treasury Board may prescribe from time to time the manner and form in which the accounts of Canada and the accounts of the several departments shall be kept, and may direct any person receiving, managing or disbursing public money to keep any books, records or accounts that the Board considers necessary."

While the responsibilities appear to be broad and responsibility for the Estimates is clearly assigned to Treasury Board, no definition of accounts is provided in the Act, and these sections, while referring to accounts, must be read in conjunction with other sections of the Act which assign more specific responsibilities in respect of accounts in other ways.

Part VI of the Financial Administration Act, entitled Public Accounts, contains two sections which read as follows:

> 54. "(1) Subject to regulations of the Treasury Board, the Receiver General shall cause accounts to be kept in such manner as to show
>
> (a) the expenditures made under each appropriation;
>
> (b) the revenues of Canada; and
>
> (c) the other payments into and out of the Consolidated Revenue Fund.
>
> (2) The Receiver General
>
> (a) shall cause accounts to be kept to show such of the assets and direct and contingent liabilities of Canada, and
>
> (b) shall establish such reserves with respect to the assets and liabilities,
>
> as, in the opinion of the Minister (of Finance), are required to give a true and fair view of the financial position of Canada.
>
> (3) The accounts of Canada shall be kept in the currency of Canada."

55. "(1) A report, called the Public Accounts, shall be prepared by the Receiver General for each fiscal year and shall be laid before the House of Commons by the Minister (of Finance) on or before the 31st day of December next following the end of that year, or if Palriament is not then sitting, within any of the first fifteen days next thereafter that Parliament is sitting.

(2) The Public Accounts shall be in such form as the Minister (of Finance) may direct, and shall include

(a) a report on the financial transactions of the fiscal year;

(b) a statement, certified by the Auditor General of Canada, of the expenditures and revenues of Canada for the fiscal year;

(c) a statement, certified by the Auditor General, of such of the assets and liabilities of Canada as in the opinion of the Minister are required to show the financial position of Canada as at the termination of the fiscal year;

(d) the contingent liabilities of Canada; and

(e) such other accounts and information as are necessary to show, with respect to the fiscal year, the financial transactions and financial position of Canada, or are required by any Act to be shown in the Public Accounts."

These two sections show that the Minister of Finance, the Treasury Board and the Receiver General all have parts to play in accounting for and reporting on the financial operations of Canada. Recognizing this shared statutory responsibility, this report has been prepared on behalf of the three departments as being their joint conclusions.

PURPOSES OF THE ACCOUNTS OF CANADA

In formulating proposals for governing the accounts of Canada in the future it is necessary to identify the various purposes that such accounts serve. These may be summarized as follows:

Accountability to Parliament

The primary purpose of the accounts of Canada is to provide Parliament with an accounting of the government's planned and actual management of its financial affairs. This includes:

- accounting for the source and use of financial resources;
- accounting for compliance with legal requirements;
- accounting for expenditures necessary to attain various government objectives; and
- accounting for the probity and prudence with which specific transactions are handled.

Fiscal policy formulation

The government's accounts assist in the process of formulating fiscal policy by providing information on:

- the allocation of resources between the private and public sectors in relation to national objectives; and
- the impact of government receipts and disbursements on output, employment, prices, balance of payments, regional disparities, and distribution of income.

Resource allocation

The government's accounts assist the resource allocation process by displaying financial costs in relation to:

- government objectives;
- departmental programs; and
- departmental activities.

The comparison of financial costs disclosed in this manner with quantitative data measuring the outputs of government programs may provide a basis for assessing the cost effectiveness and efficiency with which government objectives are being attained.

Management control

The government's accounts provide a basis for management control through:

- identifying the financial responsibility of each manager;
- providing a means of rendering an accounting to superiors;
- establishing the cost of carrying out operational objectives;
- enabling assessment of performance in relation to planned or past performance, or the performance of others;

- assisting in safeguarding cash and other assets; and

- disclosing present and potential commitments.

Cash and debt management

The government's accounts facilitate the central management of cash and debt by providing information on the cash flows, and the cash and debt balances of the government.

Economic and financial analysis

The government's accounts are an important ingredient in many types of economic and financial analyses and enable:

- the interaction of the government's transactions and those of other sectors to be analysed; and

- the government's impact on financial credit markets to be evaluated.

Informing the public

The accounts of Canada inform the public on such matters as:

- the size and growth of government expenditures;

- the costs of government programs and services;

- the sources of government revenues; and

- the stewardship of public monies and resources.

It is obvious that the range of interest in the accounts of Canada outlined above is so broad that no single set of accounts can satisfy all of these purposes equally well. The accounts of Canada are bound to be complex, with different presentations to meet different needs. The proposals in this report have tried, however, to recognize the needs of all users and to eliminate where possible unnecessary complexity.

ACCOUNTING CONCEPTS AND PRACTICES

The concepts underlying government accounting differ significantly from the concepts employed in business enterprise accounting. This is because enterprises must accept profitability as a basic objective for survival, whereas government does not. In government a quite different objective has dominated the development of its accounting. To quote from the Public Accounts, "the prime purpose of govenment accounting is to serve the requirements of Parliament and more particularly to ensure effective control by Parliament over public monies".

The government nevertheless does use enterprise accounting for certain operations in which it engages. This is where the government becomes involved in commercial or quasi-commercial operations similar to those normally carried on for purposes of profit. While this report is primarily concerned with government accounting, reference is also made to the budgetary and reporting practices of Crown corporations.

Two concepts are fundamental to the accounts of Canada. These are the concept of a single consolidated fund and the concept of parliamentary appropriation. Both have long histories, and both have had pervasive effects on the practices employed in the accounts of Canada.

Concept of a single consolidated fund

The concept of a single fund was developed in Great Britain during the 18th century. Before its establishment, specific sources of revenue were recorded in separate accounts and appropriated to finance various types of expenditure. By 1867, the concept had been firmly established in Britain, and therefore, not unexpectedly, the British North America Act directed that all duties and revenues "shall form one consolidated revenue fund". By recognizing a single fund for receiving and disbursing all government funds, government accounting acknowledges the need for a comprehensive financial reporting of government activities both prospective and retrospective.

The Financial Administration Act now defines the Consolidated Revenue Fund as "the aggregate of all public moneys that are on deposit at the credit of the Receiver General". However, it was not until 1931, that all banking arrangements were centralized. Prior to that date, funds were advanced to departments out of the Consolidated Revenue Fund in a lump-sum manner with such funds being deposited in departmental bank accounts through which transactions with third parties were recorded. In 1931, the Consolidated Revenue Fund and Audit Act eliminated for all practical purposes separate departmental bank accounts and brought them under central control thereby facilitating the accounting, reporting and control of all cash transactions going through the Consolidated Revenue Fund.

Cash accounting

In application, the concept of the Consolidated Revenue Fund has significance beyond the practice of centralized cash management. Attention in government accounting is focused on transactions involving the use of cash as opposed to transactions involving the exchange of credit. This is best explained by referring to the Public Accounts

which states that: "As parliamentary control in Canada is predicated on the operation of the Consolidated Revenue Fund, which is by law a cash account, and on regulating the flow of cash receipts into and cash payments out of the Fund, it follows that the accounts of Canada are maintained basically on a cash system".

There are, however, significant modifications to the practice of cash accounting which bring the greater part of expenditures to the accrual basis. They are as follows:

- disbursements in the 30 days following the end of the year, where they are to settle debts incurred during the year, are recorded as accounts payable and are included as expenditures of the fiscal year;

- public debt charges are accrued and amortized;

- provision is made for liabilities accruing on superannuation; and

- salary payments overlapping the fiscal year-end are apportioned between years.

Cash accounting has long been considered to meet the needs of the government, but this report examines the application of the practice and the exceptions to determine their appropriateness for present day requirements.

Definition of the Government of Canada

The concept of the Consolidated Revenue Fund has also largely determined the definition of the Government of Canada for accounting purposes. As will be explained in the next chapter, the accounting

entity known as the "Government of Canada", is generally regarded as consisting of those departments, agencies and Crown corporations, whose receipts are paid into and outlays are financed from the Consolidated Revenue Fund. An accounting entity is a recognizable unit or body carrying on economic activities within which transactions and balances between any sub-entities (whether legally established or not) are eliminated in order to report on the entity in terms of its financial relationships with outside or third parties. The definition of the Government of Canada, and the fact that transactions and balances among its components are not always eliminated, is examined in the report.

Distinction between budgetary and
non-budgetary transactions

The concept of the Consolidated Revenue Fund suggests that all transactions affecting the cash balances of the government should be included in the accounts of Canada. This is indeed the present practice. At the same time, it has been convenient to draw distinctions between different transactions, and the best known of such distinctions is the one between budgetary and non-budgetary transactions.

The Public Accounts defines non-budgetary transactions as follows: "Non-budgetary transactions are those which increase or decrease the government's assets and liability accounts and do not enter into the calculation of the annual budgetary surplus or deficit". By implication, budgetary transactions may be regarded as comprising all transactions which increase or decrease the annual budgetary surplus or deficit.

The terms budgetary and non-budgetary are partially anachronisms that date from the era when financial transactions were essentially limited to the financing of the surplus or deficit, and when the budgetary process was limited to the determination of the volume and composition

of goods and services to be acquired and the raising of revenue to cover them. In recent times, a significant number of government activities are financed by means of loans, investments and advances; these are still authorized through parliamentary appropriations. The terms "budgetary" and "non-budgetary", for the purposes of parliamentary control or fiscal planning, must therefore be regarded as mainly traditional in nature. This report recognizes a continuing need to account for these two types of transactions separately in certain financial statements of the Government of Canada, but a number of recommendations are put forward to bring the two types of transactions more closely together for purposes of the Estimates and Public Accounts.

The term non-budgetary as defined above includes foreign exchange and debt transactions, as well as loans, investments and advances and transactions affecting the various social security accounts. In the balance of this report, the term will be generally restricted to exclude foreign exchange and debt transactions. This more limited definition is used for purposes of convenience to avoid having to define the term each time it is used, and to avoid defining a new term with all the confusion that this might cause. The term, loans, investments and advances, is used wherever the report refers only to this type of non-budgetary transaction.

Concept of parliamentary appropriation

The concept that only Parliament can appropriate moneys out of the Consolidated Revenue Fund is the second major concept underlying accounting in the Government of Canada. It is through the power of appropriation that parliamentary control is effected. The traditional practice has been to appropriate by department and program, on a modified cash basis, with authority lapsing annually and on a gross basis independent of any related revenue. The report in this area is primarily devoted to examining a number of exceptions to these traditional practices, and where they do not appear to be justified, it is recommended that they be discontinued.

Appropriation by organization and purpose

Prior to 1938, the structure of appropriations in the Government of Canada varied. Since then, practice has been to appropriate spending authority first to the organizational entity accountable for the use of funds; and then by each major program for which the organization is responsible. Parliament has agreed progressively to a reduction in the number of appropriations in order to bring together within one appropriation all operations contributing to the attainment of a program's objective, including alternatives thereto. Supporting details in both the Estimates and the Public Accounts are provided in terms of the major activities necessary to attain the program's objective, as well as by the objects of expenditure which describe the resources required.

In reality, the vote structure and supporting detail primarily reflect organizational structures. The difficulties of disclosing program and activity costs on an alternative basis are considered in the report.

Modifications to the cash basis of appropriations

In keeping with the traditional practice of regarding the Consolidated Revenue Fund as a cash account, Parliament normally grants spending authority on a cash basis. However there is a significant modification to the cash basis since authority is granted to discharge debts in the 30 days following the end of the fiscal year. The significance of this and other exceptions relative to the purposes of appropriations are considered in the report.

Annually lapsing appropriations

Traditionally, Parliament has granted appropriation authority annually with unutilized authorities lapsing at the year-end. This has been to ensure opportunities for redress of grievances will be made available to Parliament each year.

Here again, there have been many exceptions, including:

- statutory authorities which permit expenditures to be made until the authority is withdrawn;

- multi-year authorities which permit spending to take place in current and future years; and

- payments or credits to special accounts so that authorities will not lapse.

The need for these exceptions is considered in the report.

Gross or net appropriations

Again, in keeping with the concept of all revenues flowing into the Consolidated Revenue Fund, Parliament normally grants spending authority on a gross basis. Revenues are credited back to an appropriation only when they represent a refund of an expenditure previously made out of the appropriation.

Parliament has permitted a number of exceptions which include:

- net appropriations which make related revenues available for expenditure;

- fund appropriations which permit revenues to be used and reused; and

- loan appropriations which permit recoveries to be re-lent.

The principle of gross appropriations, and exceptions thereto, is examined in the report.

FRAMEWORK FOR REPORTING ON THE ACCOUNTS OF CANADA

The foregoing analysis of the concepts underlying the accounts of Canada and the description of the principles and practices now being followed suggests two main areas for analysis and formulation of recommendations. The first concerns those principles and practices which are followed in accounting for and reporting in an aggregate manner on the financial affairs of the Government of Canada. This includes consideration of:

- the nature of the accounting entity covered by the accounts of the Government of Canada;
- the manner of presenting summary information on financial transactions in the Public Accounts and other financial reports;
- the manner of presenting summary data in the Estimates;
- the manner of reporting on items carried on the Statement of Assets and Liabilities; and
- the manner of reporting on budgetary revenues and expenditures on the Statement of Expenditure and Revenue.

These topics are the subject of the next five chapters of this report.

The succeeding three chapters are concerned with the detailed accounting for the government's financial transactions, both revenues and expenditures. The first chapter is concerned with revenues. The other two chapters are concerned with the accounting for appropriations - the first with all appropriations other than those granting fund authority,

and the second with fund appropriations, dealt with separately because of the significant number of departures from traditional appropriation practices.

The last chapter of the report is concerned with the manner in which the Government of Canada accounts for those enterprises which are outside the boundaries defined for the Government of Canada, and where government accounting practices are not generally applied.

CONCLUSION

This report contains a number of recommendations regarding the practices which should be employed in the accounts of Canada. It is believed that the recommendations are practical and feasible and should lead to a more consistent expression of the underlying concepts of the Consolidated Revenue Fund and parliamentary appropriation in the accounts of Canada. Questions of implementation, including any need for changes in legislation, are not considered in detail. For example, recommendations are put forward concerning the accounting treatment of assets and liabilities, revolving funds, and crown corporations, but the report does not always attempt to determine whether a specific asset, liability, revolving fund or Crown corporation should have been established and reported in the accounts, nor which accounting practice should apply to a specific situation. It is assumed that the application of the practices set forth in this report, if approved, will be the responsibility of the agency or agencies normally having responsibility in the areas concerned.

The effect of a number of the recommendations, if adopted, will be to change the level of budgetary revenues, budgetary expenditures and the budgetary surplus or deficit, with an offsetting change in the balance of non-budgetary transactions. This will result in discontinuities in the record of transactions over time, with evident disadvantages for analysts. To minimize these, it is suggested that summary statements of the accounts of Canada should be prepared for a number of past years on the new basis, as far as that is practicable.

A number of issues have been raised in recent years in the Auditor General's reports. These have been discussed on several occasions in the Public Accounts Committee. The most recent testimony was that of the Secretary of the Treasury Board in the fall of 1973 at which time the terms of reference of this study of the accounts of Canada were tabled. In a letter dated April 23, 1974 to the Chairman of the Public Accounts Committee, the Secretary listed a number of specific matters which were being examined as part of the study. The comments of the Auditor General are identified at those places in the report where the matters referred to in this letter are analysed.

Drafts of this report have been provided to the Auditor General in order to benefit from his Office's comments in preparing our final report. Generally, we have been able to accommodate any concerns expressed by his Office. In some instances, while the Auditor General supports the actions recommended in this report, he has indicated a preference for changes from present practices which go further than those that we are prepared to recommend. Where this is the case, we believe that since there is agreement on our recommendations, these should be implemented as a first step in improving the accounts of Canada. During discussions of this report and implementation of its recommendations, the Auditor General's position on these issues should be given full consideration with a view to taking such further actions as are required to improve the accounts of Canada. Where the Auditor General believes further changes should be made, these are noted in the report. We have not attempted to provide full details on the nature of his proposals or of his reasons for them since we believe these would more appropriately be presented by the Auditor General.

Chapter 1 -

DEFINITION OF THE GOVERNMENT OF CANADA FOR PURPOSES OF FINANCIAL REPORTING

The Government of Canada is made up of a large number of organizations which take a variety of legal forms and which are permitted to arrange their finances in diverse ways. In addition, a number of funds, accounts or advances have been created to finance certain programs of these organizations and these are accounted for separately. Many combinations of organizational and fund accounts could be chosen as representing those of the Government of Canada.

Under the provisions of Part VI of the Financial Administration Act, there is a statutory requirement for several financial statements or reports to be prepared for the Government of Canada of which the following are the most significant:

- a statement, certified by the Auditor General, showing such of the assets and liabilities of Canada as in the opinion of the Minister of Finance are required to show the financial position of Canada at the termination of the fiscal year;

- a statement, certified by the Auditor General, of the expenditures and revenues of Canada for the fiscal year; and

- a report on the financial transactions of the fiscal year. This is not required to be certified by the Auditor General.

This study therefore considers how the Government of Canada should be defined for purposes of these reports.

ORGANIZATIONAL COMPONENTS

Organizations deemed to be part of the Government of Canada for financial reporting purposes generally are the same as those using the Consolidated Revenue Fund for banking purposes. The previous chapter explains the effect of the concept of the Consolidated Revenue Fund in terms of centralizing cash management. Generally all organizations which are primarily governmental in nature are required to deposit their funds in the Consolidated Revenue Fund, and commercial or quasi-commercial operations, organized as Crown corporations, are allowed to make independent banking arrangements. However certain Crown corporations or agencies do not follow this usual pattern and are required to use the Consolidated Revenue Fund for banking purposes even though they have been given in most other respects the more independent status of the Crown corporation and keep their accounts in accordance with commercial accounting practices. This raises the question of whether banking arrangements should have any significance in determining whether or not the financial transactions and balances of an organization should be included among those making up the Government of Canada's revenues, expenditures, assets and liabilities for financial reporting purposes.

To appreciate the importance of arriving at a definition, it is necessary to refer back to the concept of an entity for accounting purposes as set forth in the introduction to this report. An accounting entity is a recognizable unit or body carrying on economic activities whose transactions and balances warrant accounting statements being prepared. An entity can of course be divided into sub-entities, but in accounting, a fundamental distinction is drawn between transactions taking place among sub-entities and transactions taking place between any one of them and third parties. Normally, transactions and balances between sub-entities are offset in order to prepare the financial statements of the entity in terms of its financial relationships with outside or

third parties. Thus, the manner of accounting for a specific operation will differ significantly depending upon whether or not it is defined as being part of the Government of Canada.

The organizations now using the Consolidated Revenue Fund include all departments named in Schedule A of the Financial Administration Act, all other organizations designated as departments, the staffs of the Senate, House of Commons and Library of Parliament, and any corporation named in Schedule B of the Act. In addition, five Schedule C corporations use the Consolidated Revenue Fund: the Canadian Dairy Commission, the Canadian Livestock Feed Board, the National Harbours Board, the Royal Canadian Mint and Uranium Canada Limited. The organizations which do not use the Consolidated Revenue Fund include all other Schedule C corporations, Schedule D corporations, and other corporations controlled by the Government of Canada. These are permitted by law to operate separate bank accounts outside the Consolidated Revenue Fund.

The possibility of making the defined limits of the Government of Canada fully synonymous with the organizations using the Consolidated Revenue Fund was considered. However, we concluded that this would involve us in organizational issues concerning the degree of independence the government wishes to give to the five Schedule C corporations which now are in an anomalous position. Accounting should reflect organizational decisions, not dictate them, and it was therefore concluded that, while the anomaly may be cause to re-examine present organizational designations, for purposes of this report present designations should be accepted. Banking arrangements which depart from the usual independence in this regard of Class C and D corporations were not considered to be sufficient argument for including these five corporations within the limits defined for the Government of Canada, particularly if all other Schedule C corporations continue to be excluded.

An alternative that was then considered was the possibility of a more all-encompassing definition of the Government of Canada which would include all Class C corporations, as well as Class D and all unclassified corporations owned and controlled by the government. This definition, while comprehensive and reflecting ownership or control considerations, would include governmental and commercial organizations which differ in purpose, outlook and method of accounting, and it would simply be an arithmetic compilation which would have little economic or financial significance for purposes of financial reporting. Such a compilation would overlap the generally accepted distinction between the public and private sectors. In addition, it would be technically difficult in view of the different practices of enterprise accounting which are considered appropriate for these corporations. For these reasons, it was concluded that, while the Public Accounts of Canada should continue to include the detailed accounts of all these organizations, the summary statements should be based on a more limited definition of the Government of Canada.

A definition of the Government of Canada which excludes all Class C and D Crown corporations, including those Class C corporations that now use the Consolidated Revenue Fund makes the criteria used for purposes of classifying Crown corporations very important. Among the criteria for C and D corporations should be economic and financial characteristics which differ from those normally associated with government. If the Government of Canada as a result of the criteria used includes all other organizations, namely those for which government accounting practices are appropriate, there should be no technical problems in preparing summary statements for the Government of Canada.

Recommendation 1 - *The Government of Canada should continue to be defined as consisting of all the departments named in Schedule A of the Financial Administration Act; any other*

divison or branch of the Public Service of Canada, including a commission appointed under the Inquiries Act designated by the Governor in Council as a department for purposes of the Act; the staffs of the Senate, the House of Commons and the Library of Parliament; and, any corporation named in Schedule B of the Financial Administration Act.

ACCOUNTING FOR FUNDS, ACCOUNTS AND OTHER FORMS OF ADVANCES TO ORGANIZATIONS FALLING WITHIN THE DEFINED LIMITS OF THE GOVERNMENT OF CANADA

Notwithstanding the fact that continuation of the present definition is recommended, some changes in accounting practices will be required. This is because Parliament has authorized a number of funds or accounts to be created for purposes of separate accounting of certain programs. The Old Age Security Fund and the Unemployment Insurance Account are two of the more notable funds or accounts, but in addition a considerable number of revolving funds, working capital advances and other accounts have been created. The uses of many of these funds and accounts are closely related to programs financed directly through the Consolidated Revenue Fund, and the accounts are operated by organizations falling within the limits defined for the Government of Canada. For accounting purposes, however, they have been treated as if they were advances to organizations outside, rather than inside, the boundaries of the government. For example, transactions in these accounts are excluded from the revenues and expenditures reported on the Statement of Expenditure and Revenue; and balances owing to or by them are shown as assets and liabilities of the government on its Statement of Assets and Liabilities.

Later in this report the use of these various funds is examined in greater detail. In some cases it is recongized that they should continue to be accounted for in the present manner in that the balances

in these funds are, albeit somewhat indirectly, held in trust for outside or third parties and represent financial claims due to or by such third parties including the employees of the Government of Canada. In other cases it is concluded that these funds are simply means of providing a different type of financial authority to organizations included within the accounting entity defined as the Government of Canada. Problems arise at present because appropriations to these funds or accounts are treated as non-budgetary advances, and they are therefore accounted for as if they were advances to organizations outside the Government of Canada.

In conclusion, it is fundamental to an improved summary accounting for the Government of Canada, not only that there be an agreed upon definition of the organizational components making it up, but that appropriations to such organizations be consistently treated as budgetary in the accounts of Canada. All expenditures and revenues, other than those affecting financial claims on or by third parties, should be included on the Statement of Expenditure and Revenue of the Government of Canada, and the Statement of Assets and Liabilities should not carry as assets any advances which are normally written off in accordance with the government accounting principles proposed in this report.

Recommendation 2 - *Expenditures under all appropriations granted to departments and agencies falling within the limits defined for the Government of Canada should be accounted for as budgetary, except where they give rise to financial claims, or reduce financial claims due by or to organizations and individuals outside of the entity so defined.*

Chapter 2 -

STATEMENTS OF FINANCIAL TRANSACTIONS

The Government of Canada is a very large and complex accounting entity. The volumes presenting the Estimates and the Public Accounts provide convincing evidence by their size of the very large number and variety of transactions in which it engages. As a consequence, summary statements which gather together in manageable dimensions all transactions and enable interested parties to obtain a synoptic picture and form a judgement as to the government's financial transactions for a fiscal year are an important form of communication to all users of the accounts of Canada.

There exists today a variety of summary statements of the accounts of Canada which appear in numerous official publications. The subsequent chapter of this report deals with the summaries which appear in the volumes presenting the Main and Supplementary Estimates. These are not fully comprehensive although they include all items where authority is required to expend funds. Where new authority to spend has been granted through other legislation, a forecast of such statutory expenditures is included only in some cases.

The Public Accounts contain Statements of Expenditure and Revenue, and of Assets and Liabilities which are signed by the Auditor General. The first records in summary form total budgetary transactions which have taken place in the current fiscal year, while the second records the level of financial assets and liabilities which have resulted from non-budgetary transactions. The two are comprehensive of all transactions and each is discussed in the two following chapters of this report. This chapter is solely concerned with other summary forms of reporting financial transactions - first in a government accounting framework, and second in the national accounts and financial management frameworks used by Statistics Canada.

STATEMENTS OF TRANSACTIONS CROSSING CONSOLIDATED REVENUE FUND

Statements now issued

There are several comprehensive statements which attempt to cover all transactions which cross the Consolidated Revenue Fund. Such summaries appear in the following publications:

Budget Speech - This usually provides the first public release of information forecasting the total financial operations of the government for the forthcoming year.

Budget White Paper, "Review of Government Accounts" - This contains preliminary figures reporting the financial operations for the fiscal year just completed.

Monthly Statement of Government's Financial Operations - These are issued monthly for the first eleven months of the fiscal year.

Preliminary Financial Statements for the Fiscal Year - In the month of July, the preliminary statements of the government's financial operations for the prior fiscal year are released in the Canada Gazette.

Public Accounts - The official audited statements of the government's financial transactions are tabled in Parliament early in October or as soon as Parliament next meets.

In addition to these publications, there are three major supplementary sources of information on the financial operations of the Government of Canada. These are:

- the Economic Review published by the Department of Finance each spring;
- the Bank of Canada Review published monthly; and
- the Canadian Statistical Review published monthly.

Consistency of presentation in statements

It is readily apparent that there is a lack of consistency in the manner in which these various publications present financial information and as a result the information is not comparable. This makes analysis difficult if not impossible.

The differences of treatment and presentation do not appear to reflect genuine differences in the needs of users; they have arisen simply in the process of evolution of the statements. Given the range and different forms presently utilized in displaying the financial operations of the government, users may be easily confused and sometimes misled. To avoid this situation, wherever possible, a standard set of summary statements should be used in displaying the financial operations of the government.

An illustrative set of summary statements which might be used to achieve standard practice is displayed in Exhibit 1. These statements are an extension of the form of presentation used in the Budget Speech as it has developed over time. They are based on proposed accounting practices, but would need to be further modified as a result of some of the recommendations contained elsewhere in this report.

EXHIBIT 1

GOVERNMENT OF CANADA

SUMMARY STATEMENT OF TRANSACTIONS

		Fiscal Year 1973-74	Fiscal Year 1972-73
		$ Million	
I.	BUDGETARY TRANSACTIONS		
	A. Revenues	21,864	18,821
	B. Expenditures	−23,425	−19,754
	Surplus or deficit (−)	− 1,561	− 933
II.	NON-BUDGETARY TRANSACTIONS		
	A. Loans, investments and advances	− 1,376	− 1,584
	B. Annuity, insurance and pension accounts	1,030	892
	C. Other transactions	443	369
	Net Source or requirement (−)	97	− 323
	Total transactions (excluding foreign exchange)	*− 1,464*	*− 1,256*
III.	FOREIGN EXCHANGE TRANSACTIONS	76	− 130
	Total transactions[1]	*− 1,388*	*− 1,386*
IV.	UNMATURED DEBT TRANSACTIONS	199	1,785
	Change in cash balance[2]	*− 1,189*	*− 399*
V.	LEVEL OF CASH BALANCE AT END OF PERIOD	810	1,999

1 Cash requirement (−)
2 Cash decrease (−)

EXHIBIT 1

GOVERNMENT OF CANADA

DETAILED STATEMENT OF TRANSACTIONS

	Fiscal Year 1973-74	Fiscal Year 1972-73
	$ Million	
I. **BUDGETARY TRANSACTIONS**		
A. **Revenues**		
Tax revenues		
Personal income tax		
Deductions at source	7,404	6,856
Other collections	1,822	1,523
Corporate income tax	3,710	2,920
Non-resident tax	324	292
Sales tax	3,591	3,052
Other excise taxes	408	400
Oil export tax	287	–
Excise duties	686	638
Customs import duties	1,384	1,182
Estate tax	14	61
Total tax revenues	*19,630*	*16,924*
Non-tax revenues		
Return on investments		
CMHC – interest and remitted profits	400	367
FCC – interest	79	77
Exchange Fund – remitted profits	220	203
Bank of Canada – remitted profits	373	301
Other	417	317
	1,489	*1,265*
Postal revenues	480	470
Other	265	162
Total non-tax revenues	*2,234*	*1,897*
TOTAL REVENUES	21,864	18,821
B. **Expenditures**		
Agriculture	438	337
Energy, Mines and Resources	*342*	*171*
Oil price stabilization	157	–
Other	185	171
External Affairs	435	383
Finance	*4,616*	*3,963*
Public debt charges	2,565	2,288
Fiscal transfers and contracting-out payments	1,874	1,501
Other	177	174
Industry, Trade and Commerce	400	412
Manpower and Immigration	*1,990*	*1,854*
Development and utilization of manpower	699	715
Unemployment Insurance Commission	1,226	1,080
Other	65	59
National Defence	2,224	1,938
National Health and Welfare	*6,559*	*5,448*
Family and Youth Allowance	993	608
Hospital Insurance	1,066	961
Canada Assistance Plan	507	477
Old Age Security Plan	3,035	2,524
Other	958	878
Post Office	589	498
Public Works	470	374
Regional Economic Expansion	411	360
Secretary of State	*1,072*	*940*
Post secondary education	485	481
Other	587	459
Transport	963	659
Veterans Affairs	539	446
Other departmental expenditures	2,377	1,971
TOTAL EXPENDITURES	23,425	19,754
Surplus/deficit (–)	– 1,561	– 933

EXHIBIT 1

GOVERNMENT OF CANADA

DETAILED STATEMENT OF TRANSACTIONS

	Fiscal Year 1973-74	Fiscal Year 1972-73
	$ Million	
II. NON-BUDGETARY TRANSACTIONS (source + requirement –)		
A. Loans, investments and advances		
Crown corporations and agencies	*– 1,052*	*– 745*
Lending institutions	*– 677*	*– 633*
Central Mortgage and Housing Corporation	– 375	– 475
Export Development Corporation	– 142	– 124
Farm Credit Corporation	– 170	– 43
Municipal Development Loan Board	10	9
All other Crown corporations	*– 375*	*– 112*
Air Canada	–	14
Atomic Energy of Canada Limited	– 62	– 79
Canadian National Railways	– 205	3
Other	– 108	– 50
Other Loans	*– 324*	*– 839*
Finance	– 108	– 135
Regional Economic Expansion	– 60	– 61
Canada Development Corporation	– 75	– 162
Loans to Developing Countries	– 183	– 143
Unemployment Insurance Commission	65	– 310
Other	37	– 28
TOTAL LOANS, INVESTMENTS AND ADVANCES	*– 1,376*	*– 1,584*
B. Annuity, insurance and pension accounts		
Canada Pension Plan	41	43
Superannuation accounts	988	851
Government annuities	– 19	– 13
Other	20	11
TOTAL ANNUITY, INSURANCE AND PENSION ACCOUNTS	*1,030*	*892*
C. Other Transactions		
Interest and matured debt	294	349
Accounts payable and accrued salaries	444	106
Cash in transit	– 854	– 104
Outstanding cheques, warrants and money orders	539	16
Deposit and trust accounts	– 55	30
Other	75	– 28
TOTAL OTHER TRANSACTIONS	*443*	*369*
NET NON-BUDGETARY REQUIREMENTS	97	– 323
III. FOREIGN EXCHANGE TRANSACTIONS (source + requirement –)		
Exchange Fund account	175	– 125
International Monetary Fund	*32*	*52*
Subscriptions	– 105	– 51
Notes payable	137	103
Other international organizations	*– 55*	*– 55*
Subscriptions, advances and loans	– 125	– 107
Notes payable	70	52
Unmatured debt outstanding – payable in foreign currency	– 76	– 2
TOTAL FOREIGN EXCHANGE TRANSACTIONS	*76*	*– 130*
IV. UNMATURED DEBT TRANSACTIONS (increase + decrease –)		
Marketable Bonds	93	36
Treasury Bills	615	460
Canada Savings Bonds	– 583	1,277
Other	8	7
Less:		
Unmatured debt payable in foreign currency	76	2
Securities issued to CPP Investment Fund	– 8	– 7
Security investment account – net of instalment purchase account	– 2	10
TOTAL UNMATURED DEBT TRANSACTIONS	*199*	*1,785*
V. LEVEL OF CASH BALANCE AT END OF PERIOD		
In Canadian dollars	801	1,984
In foreign currency	9	15
	810	1,999

The first statement, entitled "Summary Statement of Transactions", summarizes the transactions crossing the Consolidated Revenue Fund in a very aggregated form. The transactions are categorized under four main headings: first, the traditional budgetary transactions which affect neither assets nor liabilities and are in fact synonymous with transactions reported on the Statement of Expenditure and Revenue; second, the non-budgetary transactions which can be defined as those transactions which affect assets and liabilities but which are not of a foreign exchange nature and do not affect the unmatured debt of the government; third, the foreign exchange transactions; and fourth, transactions affecting the government's unmatured debt.

The first category, namely the traditional budgetary revenues and expenditures, has an historical significance and without exception, is used in all official publications relating to government operations when displayed in a government accounting form. Budgetary expenditures include accrued as well as cash transactions. Both budgetary revenues and expenditures contain some degree of netting. The net difference between revenues and expenditures results in the budgetary surplus or deficit.

The second category is referred to as non-budgetary transactions. As a result of both the interlocking nature of budgetary and non-budgetary transactions and the ever-increasing emphasis placed on the use of non-budgetary transactions to implement fiscal policy, there has been a growing awareness that these two categories cannot be considered in total isolation. Increasingly, the total of financial transactions - whether budgetary or non-budgetary in nature - is being used to measure the impact of government activity from both the fiscal and monetary points of view. A prime example of the interlocking feature of budgetary and non-budgetary transactions is the method of allocating current receipts as between the two categories. Receipts for Old Age Security, Unemployment Insurance, the Canada Pension Plan and provincial tax

collections are first estimated from collections made by National Revenue (Taxation) with apppropriate adjustments when actual figures are determined. The existence of such estimates means that both budgetary and non-budgetary positions are altered when the adjustments to actual figures are made between these non-budgetary accounts and budgetary tax revenues. The budgetary category contains accrued expenditures which are offset by entries for accounts payable in the non-budgetary section in order to arrive at net cash requirements. The government's role in financial intermediation has been growing in significance and importance and now comprises an integral part of the fiscal policy structure. In dollar terms the net balance of non-budgetary transactions normally outstrips the budgetary surplus or deficit. In planning a fiscal framework and for other analysis, the non-budgetary classifications required are those for loans, investments and advances; annuity, insurance and pension accounts; and changes in accrued items and cash in transit.

The third category is referred to as foreign exchange transactions. Non-budgetary transactions are generally defined to include foreign exchange transactions, but due to the different character of the two types of transactions, it seems appropriate to segregate foreign exchange transactions from other non-budgetary transactions. The forces which give rise to foreign exchange transactions are normally of an international nature rather than national in scope. As a result, foreign exchange transactions are not as readily forecastable or subject to the same degree of control as other non-budgetary transactions. In the case of a fixed exchange rate, the government undertakes to buy and sell foreign exchange to maintain the exchange rate of the Canadian dollar within fixed limits. In the case of a floating exchange rate, while the government is not legally committed to such an undertaking, it intervenes from time to time in the foreign exchange markets so as to ensure, to the extent possible, that orderly market conditions prevail. Transactions with the International Monetary Fund, other international organizations and the monetary authorities of other countries and the issue of foreign currency bonds are closely related to the management of foreign exchange reserves.

The fourth category is the unmatured debt transactions. These transactions are by nature quite separate from other non-budgetary transactions. Unmatured debt transactions can in one sense be considered residual transactions emanating from other transactions insofar as they form a means of financing other government operations. This type of transaction is analysed more from the point of view of its impact on capital markets rather than its effect on fiscal conditions.

The second statement in Exhibit 1 displays in a more disaggregated form the financial operations of the government within each of the four broad categories distinguished in the summary statement and just explained.

> Recommendation 3 - *In those publications presenting summary statements of the Government of Canada's financial transactions, a standard form of presentation should be utilized.*

Need for additional monthly statements

The statements in the Budget Speech set out a forecast of the financial transactions of the government for a given fiscal year. The actual out-turn is displayed by way of the Public Accounts. In the intervening period, monthly statements of financial transactions are released. These monthly statements provide the user with a means of tracing the forecast made at the time of the Budget. Currently, separate statements for the month of March and the supplementary period are not published thereby making monthly analysis most difficult.

A statement should be released for the month of March including the totals for the first 12 months with an appropriate explanation that, at this point in time, the final cash balances for the fiscal year have been determined, but transactions in the supplementary period will have significant effect on budgetary revenues and expenditures and the

resulting budgetary surplus or deficit. It should also be explained that the offset to the change in the budgetary surplus or deficit position is reflected in the non-budgetary section as cash balances will remain unchanged.

It is further proposed that a statement should be issued to cover the supplementary period and thus complete the series. The intent is that the figure in this statement, on a year-to-date basis, when added to previous statements, should be very close to the final figures which will be issued in the Public Accounts some months later. Such a statement could thus be included in the publication "Preliminary Financial Statements for the Fiscal Year" along with the additional data on assets and liabilities and net debt position which are now included in this publication.

> Recommendation 4 - *The current practice of publishing a statement of government financial operations through the Canada Gazette should be extended to cover separately the month of March. In the "Preliminary Financial Statements for the Fiscal Year" a standard set of tables for the supplementary period after the fiscal year-end should be included, as well as the present tables providing a preliminary statement of assets and liabilities and net debt position.*

SUPPLEMENTARY SYSTEMS OF ACCOUNTS

The summary statements discussed in the preceding section can be expected to satisfy the needs of many users. They summarize the accounts of Canada which are designed primarily to serve the needs of Parliament from the point of view first of accountability and second of administrative control. But no single form of presentation can meet all needs.

There are two other systems of accounts which are used for measuring and reporting on the government's financial transactions. These are the system of National Accounts[1] and the system of Financial Management Accounts. Both these systems are quasi-derivative in that the bulk of the data is generated from the accounts of Canada. The system of National Accounts which is based on internationally accepted practices is designed to measure the transactions of the government in a conceptual framework compatible with that used in measuring other sectors of the economy. It is thus of particular value for economic analysis. The Financial Management Accounts are designed to measure in a uniform and consistent way, data on the financial transactions of all levels of government in Canada, and thereby provide a set of statistics for federal-provincial discussions of fiscal policy and debt management. Both supplementary systems of accounts need to be retained and improved.

The Budget presented by the President of the United States for the fiscal year 1969 was in a form radically different from the traditional form of presentation. The new form of presentation had the advantage of becoming the only form of presentation and thereby eliminating much of the confusion which arose from the use, in previous years, of three different budgets which varied in accounting methods and coverage. This new unified budget concept has been criticized basically from two fronts. In the first instance, it was felt that the surplus or deficit, derived from the accrual concept to which the new budget subscribed, did not in fact reflect the cash requirement of the government and any analysis of the impact of government operations on both capital markets and money

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(1) In this section the term "National Accounts" shall be construed to mean that part of the total system of National Accounts which refers to the presentation of the federal government's revenues and expenditures on a National Accounts base. The term "Extended National Accounts" is defined for purposes of this report as all transactions of the federal government which affect the change in the government cash balance commencing with the revenues and expenditures on a National Accounts base.

supply was made most difficult. Secondly, the use of the accrual basis of accounting for the government, while consistent with other sections of the National Accounts, was out of phase with the National Accounts system in its treatment of loan activity in that loan activity was included, whereas it is excluded in the National Accounts system. In designing the Canadian system of reporting, the balance of advantages was considered to lie in the development of alternative presentations, unified only at the level of overall cash requirements.

Extended National Accounts

The coverage of the National Accounts is wider than the budgetary portion of the accounts of Canada. In the system of National Accounts, for example, taxes collected on behalf of the Old Age Security Fund and the Unemployment Insurance Commission are considered as part of direct taxes and employer and employee contributions to government superannuation accounts are also considered as part of current revenue and allocated to direct taxes. On the expenditure side, pension payments from the Old Age Security Fund and the government superannuation accounts as well as benefit payments by the Unemployment Insurance Commission are all classified as current expenditures. The activity of some Crown corporations and agencies is also considered as part of current transactions as opposed to their non-budgetary treatment in the Public Accounts. Moreover there are a number of differences in accounting treatment - for example, corporate tax revenues are recorded on an accrual basis in the National Accounts rather than on a cash basis as in the Public Accounts, and capital formation is treated differently.

While the National Income and Expenditure Accounts are less restricted than the budgetary section of the accounts of Canada, they do not fully embrace the whole of the government's financial transactions. For a summary of all the government's financial transactions, it is necessary to refer to transactions which are not included in the National

Income and Expenditure Accounts, but which are reflected in the National Financial Flows Accounts. The most serious omission is loans to persons, non-residents, businesses and those Crown corporations and agencies which are not considered as part of the government sector.
The omission of these loans tends to understate the level of economic activity attributable to the government sector. Since the government has increased, in the recent past, its reliance on loans and related activity, as a substitute for grants and subsidies, the degree to which the government sector is being down-played is of course becoming more acute. Because the National Income and Expenditure Accounts do not reflect these loans, the role of government in the financing of economic activity taking place in other sectors of the economy is not adequately revealed.

Without redefining the government sector in the National Income and Expenditure Accounts and without incorporating the full system of Financial Flows Accounts for the government sector, one can attempt to serve more adequately the needs of those interested in analysing the fiscal and monetary stance of the government. This can be done by adding to the National Accounts presentation, as currently defined, a section similar to the non-budgetary sections of the standard statements proposed for reporting financial transactions. This section would encompass all those financial and other transactions not included in arriving at the current surplus or deficit. This section would also include those accounts necessary to revert from the accrual basis of revenues and expenditures to arrive at a cash basis. The foreign exchange and debt transactions as well as the change in cash would be the same in the Extended National Accounts presentation as in the standard Public Accounts presentation.

It should be emphasized that this Extended National Accounts presentation in no way alters the present definition of the current surplus or deficit on a National Accounts basis; but it simply complements

the latter system by introducing those government transactions that are currently omitted from it. In this manner it provides a complete accounting for all changes in the government's cash balances. The insertion of currently omitted transactions is by way of separate and independent sections. The Extended National Accounts would then provide the necessary data for those interested in evaluating the impact of financial and other transactions. This information, under the current system, is not readily available. The non-budgetary section of the Extended National Accounts presentation would exclude all transactions now included in the non-budgetary section of the Public Accounts presentation of financial transactions, such as the activity in the Old Age Security Account, the Unemployment Insurance Account and the Superannuation Accounts, but which have been included in the National Accounts system in arriving at the current accounts surplus or deficit. The financial section of the Extended National Accounts will be defined somewhat differently from the non-budgetary section of the standard statements in line with the conceptual differences between the two systems, but it would be reconcilable.

The above discussion of the differences between the Extended National Accounts system on the one hand and the standard statements proposed for the government on the other hand, has been based on present accounting practices. The adoption of the recommendations put forward in this report will have the effect of eliminating some of the differences which now exist, but there will continue to be some differences between the two systems and the alternative presentations will be of value to different classes of users.

Recommendation 5 - *The current practice of displaying the government's transactions in a National Accounts framework for revenues and expenditures should be extended to include loans and other transactions to third parties so as to display the total financial requirements of the government for any given period.*

As previously noted the National Accounts presentation is quasi-derivative in that the bulk of the data is generated from the accounts of Canada. Accordingly, it would appear convenient to have the Department of Supply and Services used to the greatest extent possible to produce statements in a National Accounts framework.

It is important to recognize that the concepts and definitions used in the National Accounts are governed by the need to maintain consistency between sectors of the Canadian economy. To facilitate international comparisons, the United Nations and other international organizations have developed standards to which all member countries including Canada adhere. The responsibility for the concepts and definitions employed in the National Accounts of Canada is vested in Statistics Canada. If the National Accounts statements are to be produced from the central accounting system, it is essential that this be done in accordance with approved concepts and definitions.

It is also important to recognize that the central accounting system in its present state does not contain all the information necessary to produce a National Accounts presentation. The major exceptions are the receipts and disbursements of those agencies such as Atomic Energy of Canada which for purposes of the National Accounts are considered as part of the government sector. Consideration will also have to be given to the source of input for such items as corporate accruals not currently part of the central accounting system. Since these items are currently calculated by Statistics Canada, it appears appropriate that it would provide this information to Supply and Services on a monthly basis.

With regard to the receipts and disbursements of those agencies which, for purposes of the National Accounts, are considered as part of the government sector, it would appear appropriate that the agencies in question be requested to provide the required information on a monthly basis.

The monthly production of an Extended National Accounts presentation from the central accounting system maintained by the Receiver General for Canada raises the possibility that there could be two sets of National Accounts tabulations for Canada, at least on a quarterly and annual bases. These differences could arise because of the policies of Statistics Canada of revising its estimates, because of differing classifications of items displayed in the monthly series where items must be classified before all relevant information may be available, and because of the tentative nature of certain important adjustments which would have to be provided to the Receiver General by Statistics Canada on a monthly basis.

Recognizing these problems and the responsibility of Statistics Canada for the concepts and definitions employed in the National Accounts and also their ultimate responsibility for the statistical estimates used in the quarterly National Accounts, agreement should be sought to minimize any incompatability of the data and to arrive at procedures that are mutually satisfactory. Such agreement would have to reflect the policies of Statistics Canada for the revision of estimates and its ability to provide monthly adjustments to the Receiver General for Canada within the time schedules for the publications of the Receiver General.

The financial operations of the government are first forecast in the Budget Speech, with monthly statements being provided throughout the period and the actual out-turn being presented in the Public Accounts. This order of publication also appears to be appropriate in the case of the National Accounts. A form of statements recommended for release with the Public Accounts statements, together with a reconciliation between the two systems, is set out in Exhibits 2 and 3.

> Recommendation 6 - *The publication of government financial operations through the Budget Speech, the Public Accounts and the Canada Gazette should be expanded to include the presentation of transactions on an Extended National Accounts basis including reconciliations where appropriate.*

EXHIBIT 2

GOVERNMENT OF CANADA

SUMMARY EXTENDED NATIONAL ACCOUNTS PRESENTATION

		Fiscal Year 1973-74 ($ Million)	Fiscal Year 1972-73 ($ Million)
I.	**CURRENT TRANSACTIONS**		
	A. Revenues	23,568	20,439
	B. Expenditures	−23,743	−20,780
	Surplus or deficit (−)	− 175	− 341
II.	**LOANS AND OTHER TRANSACTIONS**		
	A. Loans, investments and advances	− 1,393	− 1,225
	B. Cash vs. accruals	216	314
	C. Other transactions	− 112	− 4
	Net source or requirement (−)	− 1,289	− 915
	Total requirements (excluding foreign exchange)	*− 1,464*	*− 1,256*
III.	**FOREIGN EXCHANGE TRANSACTIONS**[1]	76	− 130
	Total requirements[1]	*− 1,388*	*− 1,386*
IV.	**UNMATURED DEBT TRANSACTIONS**[2]	199	1,785
	Change in cash balance[2]	*−1,189*	*− 399*
V.	**LEVEL OF CASH BALANCE AT END OF PERIOD**	810	1,999

1 Cash requirement (−)
2 Cash decrease (−)

EXHIBIT 2

GOVERNMENT OF CANADA

SUMMARY EXTENDED NATIONAL ACCOUNTS PRESENTATION

	Fiscal Year 1973-74	Fiscal Year 1972-73
	$ Million	
I. CURRENT TRANSACTIONS		
A. Revenues		
Direct taxes		
Persons	11,028	9,900
Corporations	3,627	2,848
Non-residents	322	298
Total direct taxes	*14,977*	*13,046*
Indirect taxes	6,485	5,306
Other current transfers from persons	7	5
Investment income	1,783	1,805
Capital consumption allowances	316	277
TOTAL REVENUES	23,568	20,439
B. Expenditures		
Current goods and services		
Non-defence	4,023	3,616
Defence	2,292	1,998
Total current goods and services	*6,315*	*5,614*
Transfer payments to persons	7,467	6,468
Subsidies	1,052	661
Capital assistance	178	227
Current transfers to non-residents	336	304
Interest on the public debt	2,520	2,268
Transfers to provinces	4,954	4,474
Transfers to local governments	123	140
Gross capital formation	798	624
TOTAL EXPENDITURES	23,743	20,780
Surplus (+) or Deficit (–)	– 175	– 341
II. LOANS AND OTHER TRANSACTIONS		
A. Loans, investments and advances		
Lending institutions		
Central Mortgage and Housing Corporation	– 375	– 475
Export Development Corporation	– 141	– 124
Farm Credit Corporation	– 170	– 43
Veterans Land Act	– 7	– 2
Total	– *693*	– *644*
Regional Economic Development		
Stabilization and development loans to provinces	– 105	– 135
Regional Economic Expansion	– 61	– 64
Industry, Trade and Commerce — misc. loans	– 12	– 7
Municipal Development Loan Board	10	9
Total	– *169*	– *197*
Transportation and Communication		
Air Canada	–	14
Canadian National Railways	– 206	2
St. Lawrence Seaway	– 6	– 32
Other	– 52	– 25
Total	– *264*	– *41*
Loans to other levels of government		
Domestic	– 12	– 7
International	– 146	– 107
Total	– *158*	– *114*
Miscellaneous		
Canada Development Corporation	– 75	– 162
Other	– 34	– 67
Total	– *109*	– *229*
TOTAL LOANS, INVESTMENTS AND ADVANCES	– 1,393	– 1,225
B. Accrual Accounts		
Interest accounts	320	346
Supplementary period accounts	– 400	– 48
Corporate income tax	11	– 1
Oil export tax	– 224	–
Gross capital formation	– 30	1
Outstanding cheques, warrants and money orders	539	16
TOTAL CASH vs. ACCRUALS	216	314
C. Other Transactions		
Provincial tax collections account	– 44	8
Other	– 68	– 12
TOTAL OTHER TRANSACTIONS	– 112	– 4
NET LOANS AND OTHER TRANSACTIONS	– 1,289	– 915

EXHIBIT 3

GOVERNMENT OF CANADA

STATEMENT OF TRANSACTIONS

SUMMARY PUBLIC ACCOUNTS AND EXTENDED NATIONAL ACCOUNTS RECONCILIATION

$ Million

		Fiscal Year Ending March 31st					
		1974			1973		
		P.A.	E.N.A.	Difference	P.A.	E.N.A.	Difference
I	BUDGETARY TRANSACTIONS/CURRENT TRANSACTIONS						
	A. Revenues	21,864	23,568	−1,704	18,821	20,439	−1,618
	B Expenditures	23,425	-23,743	318	−19,754	−20,780	1,026
	Surplus (+) or deficit (−)	− 1,561	− 175	−1,386	− 933	− 341	− 592
II	NON-BUDGETARY TRANSACTIONS/LOANS AND OTHER TRANSACTIONS [1]	97	− 1,289	1,386	− 323	− 915	592
	Total requirements (excluding foreign exchange)[1]	*− 1,464*	*− 1,464*	−	*− 1,256*	*− 1,256*	−
III	FOREIGN EXCHANGE TRANSACTIONS[1]	76	76	−	− 130	− 130	−
	Total requirements[1]	*− 1,388*	*− 1,388*	−	*− 1,386*	*− 1,386*	−
IV	UNMATURED DEBT TRANSACTIONS[2]	199	199	−	1,785	1,785	−
	Change in cash balance[2]	*− 1,189*	*− 1,189*	−	*399*	*399*	−
V	LEVEL OF CASH BALANCE AT END OF PERIOD	810	810	−	1,999	1,999	−

1 Cash requirement (−)
2 Cash decrease (−)

EXHIBIT 3

GOVERNMENT OF CANADA

STATEMENT OF TRANSACTIONS

DETAILED PUBLIC ACCOUNTS AND EXTENDED NATIONAL ACCOUNTS RECONCILIATION

	Fiscal Year 1973-74	1972-73
	$ Million	
I. BUDGETARY TRANSACTIONS/CURRENT TRANSACTIONS		
A. Revenues		
Budgetary revenue — Public Accounts	21,864.0	18,821.0
Deduct		
Post Office revenue and deficit	− 591.2	− 463.7
Deficit of government business enterprises	− 125.2	− 89.4
Excess of accruals over collections		
Corporate income tax	− 11.0	0.5
Oil export tax	224.4	—
Add		
Government pensions and social security receipts	2,391.1	1,916.4
Capital consumption allowance	316.0	277.0
Miscellaneous adjustments	− 500.1	− 22.8
CURRENT REVENUES — EXTENDED NATIONAL ACCOUNTS	23,568.0	20,439.0
B. Expenditures		
Budgetary expenditures — Public Accounts	23,425.0	19,754.0
Deduct		
Budgetary transfers to funds and agencies	− 2,128.7	− 1,807.1
Post Office expenditures	− 591.2	− 463.7
Deficit of government business enterprises	− 125.2	− 89.4
Add		
Expenditures of funds and agencies	935.2	728.9
Government pensions and social security benefits	2,505.0	2,453.9
Capital consumption allowance	316.0	277.0
Miscellaneous adjustments	− 593.1	− 73.6
CURRENT EXPENDITURES — EXTENDED NATIONAL ACCOUNTS	23,743.0	20,780.0
II. NON-BUDGETARY TRANSACTIONS/LOANS AND OTHER TRANSACTIONS		
Non-budgetary transactions — Public Accounts	97.0	− 323.0
Deduct		
Loans and advances to funds and agencies	24.0	− 16.0
Government pensions and social security accounts	− 1,039.0	− 490.0
Reserves and revolving funds	− 19.0	5.0
Excess of accruals over collections		
Corporate income tax	11.0	—
Oil export tax	− 225.0	—
Miscellaneous adjustments	− 138.0	− 91.0
LOANS AND OTHER TRANSACTIONS — EXTENDED NATIONAL ACCOUNTS	− 1,289.0	− 915.0

Financial Management System

As in the case of Extended National Accounts, the bulk of the information required to produce statements on a Financial Management base is currently available within the central accounting system. The production of the Extended National Accounts directly from the central accounts would also greatly reduce the amount of additional information required to produce statements for the Financial Management System. Accordingly, these statements could also be produced by the Department of Supply and Services.

The responsibility for the concepts and definitions employed in the Financial Management System is vested in Statistics Canada. No changes are suggested in this regard. If the Financial Management System is to be produced directly from the central accounting system, it is essential that this be done in accordance with approved concepts and definitions.

At present the Financial Management statements are produced only on an annual basis. Supply and Services should be prepared to produce statements more frequently in the event that such information is requested. The data bank should also be flexible so as to integrate changes in definitions and concepts and be capable of recasting an historical series of statements in accordance with the changes in definitions and concepts.

VIEWS OF AUDITOR GENERAL ON RECOMMENDATIONS

The Auditor General and the Independent Review Committee on the office of the Auditor General have indicated that they favour a new statement showing changes in financial position during the fiscal year and the causes of such changes, that such a statement should be added to the Statement of Assets and Liabilities and of Expenditures and Revenue, and the three main financial statements should appear together in the Public Accounts.

The Office of the Auditor General has been consulted on the illustrative statements of financial transactions proposed in this chapter. His preference is for a different presentation. The main differences are that such a statement would more clearly indicate non-cash entries affecting the computation of the budgetary surplus or deficit for the year; it would place emphasis on the change in unmatured debt, rather than change in cash balances, by having the unmatured debt at the end of the year, rather than the cash balance, the last item reported on the statement. Since there is agreement on the need for an additional statement, further discussions should take place with the Office of the Auditor General on these matters of presentation in the course of implementing the proposals in this report.

Chapter 3 -

PRESENTATION OF SUMMARY INFORMATION IN ESTIMATES

The main purpose of the Estimates is to present to Parliament the budgetary expenditure proposals for the coming fiscal year as well as non-budgetary loans, investments and advances for which authority is requested. The Estimates include items, referred to as votes, which Parliament is asked to approve through appropriation acts, as well as other items, called statutory, for which the required authority is provided through existing legislation. Estimates of expenditure authorities likely to be exercised in the fiscal year under statutory authorities are shown for information purposes only.

A number of specific proposals to alter practices in accounting for appropriations are contained in later chapters. This chapter examines the nature of data which is now presented in the Estimates; puts forward proposals to improve the comparability of such data between fiscal years; and concludes with some suggestions for improving the presentation of summary tables in the Estimates and Supplementary Estimates.

NATURE OF DATA IN ESTIMATES

Traditionally, the Estimates were designed to obtain authority for expenditures, and were not intended to be a comprehensive budget covering all planned expenditures.

More recently, steps were taken to provide a complete presentation of appropriations classified as budgetary even where authority had already been granted by means of non-lapsing statutes. As a result, the Estimates summaries now provide a fairly complete presentation of budgetary expenditures anticipated under new annual authorities proposed in the Estimates as well as under statutory authorities previously approved.

The total of budgetary expenditures for the coming year indicated in the Main Estimates, however, cannot be interpreted as giving an accurate forecast of the probable outcome of budgetary expenditure for the year. This is because:

- Supplementary Estimates and new statutory authorities granted later in the year will augment the authorization contained in the Main Estimates;

- expenditures under statutory authorities may prove to be different than those anticipated in the Main Estimates;

- while a few appropriations make provision for lapses, most do not, and therefore actual expenditures will fall somewhat short of the amounts included in the Estimates; and

- some budgetary appropriations grant authority for the current and subsequent fiscal years, but no forecast is made of expenditures under multi-year authorities of this type previously granted. Furthermore, there is no attempt to reduce the amount of the current year's authorization to reflect expenditures that may not take place until future fiscal years.

The Main Estimates are of necessity only estimates of what may take place, and therefore nothing can be done to remedy the first three items, although the Minister of Finance may in his Budget Speech make some overall adjustments in forecasting expenditures for the Estimates year in order to recognize these factors. The usefulness of the Estimates would be improved, however, by altering the last practice outlined above.

With regard to loans, investments and advances, no attempt is presently made to provide a comprehensive summary in the Estimates of anticipated advances under all existing authorities of this nature. The practice has been to include in the Estimates only the amounts of authorizations required, not the amounts expected to be utilized. Because the use of non-lapsing appropriations is more pronounced in the case of loans, investments and advances, the total amounts to be voted are by no means an accurate indication of amounts likely to be advanced during the fiscal year for these purposes.

The Estimates also include the operating budgets of revolving funds and certain other accounts which prepare their budgets on an accrual basis. Such information was first included in the Estimates in 1969 because of the increasing practice of financing certain common service or manufacturing operations by means of non-lapsing and revolving authorities. Because this removed from parliamentary scrutiny certain operations that had previously been included in the Estimates, it was felt that their budgets should be included in the Estimates even though they were computed on a different basis and did not necessarily relate directly to any appropriation authorities that were then being requested.

Thus, the Estimates today convey a number of types of information - for example, amounts to be voted, anticipated expenditures and cost data - causing, no doubt, some confusion in the minds of the users as well as creating difficulties in summarizing data of this variety.

COMPARABILITY OF ESTIMATES DATA

In addition to the variety of data provided in the Estimates book for the Estimates year, there is also a variation in the manner in which comparisons are made with data pertaining to previous years. Some tables in the Estimates book compare amounts to be voted and forecast expenditures under statutory authorities to similar amounts for the year

just ending. Others compare these same amounts for the Estimates year with an updated forecast of expenditures under both annual and statutory authorities for the year just ending. A further comparison is drawn to the year prior to that - namely, the last completed year for which actual expenditures are available. In the case of both types of comparisons, it is actual expenditures for that year, not amounts to be voted or previous forecasts, that are used for comparison purposes.

There are problems with both types of comparisons. An estimates to estimates comparison omits for obvious reasons any Supplementary Estimates that may be requested later in the Estimates year. It either omits or requires a forecast to be made of final Supplementary Estimates for the year about to end. Actual expenditures for the last completed year are of no relevance in this type of comparison. The comparison of estimates to forecast or actual expenditures is also misleading because estimates fail to recognize future Supplementary Estimates and potential lapses; the forecast for the year about to end must be made with three months yet to run and final Supplementary Estimates and lapses yet to be conclusively determined; and the actual expenditures of the year that has ended obviously include expenditures under all Estimates and record all lapses. In the case of non-budgetary loans, investments and advances, the comparisons are even more misleading because authorizations are requested irregularly and thus often bear little relationship from year to year, and even less to actual expenditures for the year about to end or for the year just ended, the last year for which actual expenditures are available.

The potentially misleading nature of the Estimates would be remedied if a clearer distinction were made between data conveying information on amounts to be voted and data conveying estimates of expenditures. This could be accomplished by presenting amounts to be voted in the Estimates separately from information which seeks to display estimated expenditures. The latter would in most cases include estimates

of amounts expected to be spent under annual appropriations, which normally would be identical to the amounts to be voted, but it would also include amounts expected to be spent under authorities previously granted. This would include not only those statutory authorities which are now included, but also expenditures under multi-year authorities.

To clarify the nature of the comparisons being drawn in the Estimates it is suggested that terminology should be more precisely defined, and as defined, should be used consistently throughout the Estimates book. We suggest the following terminology and definitions:

Amounts to be voted - refers to amounts of authority being requested in the Estimates currently being submitted, or in other Estimates for the year previously submitted.

Estimates of expenditures - refers to expenditures under authorities currently being requested or previously granted, including annual, multi-year and statutory appropriations. This is normally used to refer to the year covered by the Estimates book and thus quite obviously cannot include any forecast of expenditures under authorities yet to be requested, nor does it include any allowances for lapses other than those already reflected in the amounts to be voted.

Forecast of expenditures - refers to estimated expenditures normally for the year prior to the one covered by the Estimates book and thus can and does include forecasts of expenditures under authorities yet to be requested since these can be forecast reasonably accurately by this time. It also differs from estimates of expenditures for the Estimates year in that it forecasts lapses.

Actual expenditures - refers to actual expenditures thereby including actual expenditures under all authorities and reflecting all lapses.

Presentation of amounts to be voted separately from estimates of expenditures for the Estimates year would clearly indicate when the two are significantly different and would facilitate the preparation of summary schedules which contain like data and which make more valid comparisons among fiscal years. It would also permit information on net amounts forecast as being required by revolving funds and working capital advance authorities in the supporting details to be brought forward into the summary tables where the nature of the data as estimates of expenditures, not amounts to be voted, would be clearly indicated. This proposal would also permit more information to be included on non-budgetary loans, investments and advances than is now the practice.

Recommendation 7 - *For both budgetary appropriations and non-budgetary loans, investments and advances, the amounts presented in summary tables in the Estimates book for the Estimates year should show, as required, amounts to be voted separately from estimates of expenditures. Estimates of expenditures should show amounts expected to be expended not only under annual and statutory authorities as at present, but also net amounts required or provided under fund and other multi-year authorities not now included.*

SUMMARY TABLES IN ESTIMATES

In the front of the Main Estimates, there are now a number of summary tables which bring together the information submitted by departments in the balance of the Estimates book. Two of these summaries should be significantly changed:

Table 1 - Total Estimates - this compares Main, Supplementary and Final Supplementary Estimates for the last ten years. The figures for the Supplementary and Final Supplementary Estimates disclose estimates under amounts to be voted separately from statutory items. The table has two portions -one for budgetary appropriations and one for non-budgetary loans, investments and advances.

Table 2 - General Summary - this is a General Summary of the proposed Main Estimates by each department and agency, with comparative data showing the amounts of the prior year's Estimates, including Supplementaries already presented. Budgetary appropriations are split between estimates under amounts to be voted and under statutory items, with amounts to be voted under non-budgetary loans, investments and advances authorities being shown in separate columns.

Both of these tables show in total, as a separate amount, the Supplementary Estimates expected to be submitted before the end of the year about to terminate.

We believe that the nature of the data on these tables could be improved by:

- showing amounts to be voted in separate columns, so that a comparison can be made of new authority granted by way of the Estimates process;

- including in estimates of expenditures the multi-year and other appropriations that are not now included; and

- presenting actual expenditures for the last complete year so that it will be compared with estimates and forecasts of expenditures, and not with amounts to be voted.

Exhibits 4 and 5 illustrate how Main Estimates Tables 1 and 2 respectively might be revised to have this effect. It is important to emphasize that these are intended as illustrations only. They are designed to show the practicability of our proposals, but alternative and simpler changes might be substituted in the course of implementation.

It should be noted on Exhibit 4 that the last column on the right, headed Actual Expenditure, provides a forecast of the probable outcome for the fiscal year about to end. The practice of making this forecast was introduced in the present Main Estimates Table 1 as a result of a recommendation of the Royal Commission on Government Organization. Previously while comparisons between the estimates and forecast expenditures for the preceding year had been included in the details supporting the Estimates, summaries had compared estimates with the prior year's estimates only. The Commission, while recognizing that forecasts can never be entirely correct, felt that an up-to-date forecast provided a more meaningful comparison.

As a result of current practices, a forecast of budgetary expenditures for the year just ending is available through the Main Estimates. This forecast made several months before the end of the year can vary significantly from the actual outcome of the year's expenditures and may differ from a forecast usually made by the Minister of Finance in his Budget Speech.

The comparisons drawn on Main Estimates Table 1 between estimates of expenditures and actual expenditures will show that these normally differ because of lapses, and will show, by leaving all but the first two columns blank for the Estimates year, that the total estimates of

EXHIBIT 4

TABLE 1 – TOTAL ESTIMATES
(in millions of dollars)

– BUDGETARY –

Estimates 1974-75

Fiscal Year	Main Estimates		Supplementary Estimates		Total Estimates		Actual Expenditure
	Amounts to be Voted	Estimates of Expenditure	Amounts to be Voted	Estimates of Expenditure	Amounts to be Voted	Estimates of Expenditure	
1963-64	x,xxx.x	x,xxx.x	xxx.x	x,xxx.x	x,xxx.x	x,xxx.x	x,xxx.x
1964-65	x,xxx.x	x,xxx.x	xxx.x	x,xxx.x	x,xxx.x	x,xxx.x	x,xxx.x
1665-66	x,xxx.x	x,xxx.x	xxx.x	x,xxx.x	x,xxx.x	x,xxx.x	x,xxx.x
1973-74	xx,xxx.x	xx,xxx.x	xxx.x(1) xxx.x(2)	xx,xxx.x(1) x,xxx.x(2)	xx,xxx.x(1) xxx.x(2)	xx,xxx.x(1) x,xxx.x(2)	xx,xxx.x(3)
1974-75	xx,xxx.x	xx,xxx.x	–	–	–	–	–

LOANS, INVESTMENTS AND ADVANCES

– NON-BUDGETARY –

Fiscal Year	Main Estimates		Supplementary Estimates		Total Estimates		Actual Expenditure
	Amounts to be Voted	Estimates of Expenditure	Amounts to be Voted	Estimates of Expenditure	Amounts to be Voted	Estimates of Expenditure	
1963-64	x,xxx.x	x,xxx.x	xxx.x	xxx.x	x,xxx.x	x,xxx.x	x,xxx.x
1964-65	x,xxx.x	x,xxx.x	xxx.x	xxx.x	x,xxx.x	x,xxx.x	x,xxx.x
1965-66	x,xxx.x	x,xxx.x	xxx.x	xxx.x	x,xxx.x	x,xxx.x	x,xxx.x
1973-74	xx,xxx.x	xx,xxx.x	xxx.x(1) xxx.x(2)	xx,xxx.x(1) x,xxx.x(2)	xx,xxx.x(1) xxx.x(2)	xx,xxx.x(1) x,xxx.x(2)	xx,xxx.x(3)
1974-75	xx,xxx.x	xx,xxx.x	–	–	–	–	–

(1) Represents amounts included in Estimates submitted to Parliament.

(2) Represents amounts to be included in Supplementary Estimates yet to be submitted to Parliament.

(3) Forecast as at December 31, 1973.

EXHIBIT 5

MAIN ESTIMATES

TABLE 2 – GENERAL SUMMARY
(in thousands of dollars)

ALL DEPARTMENTS

		Budgetary						Loans, Investments and Advances					
Page	Department or Agency	Amounts to be Voted 1974-75	Amounts to be Voted 1973-74	Change	Estimates of Expenditure 1974-75	Forecast of Expenditure 1973-74	Actual Expenditure 1972-73	Amounts to be Voted 1974-75	Amounts to be Voted 1973-74	Change	Estimates of Expenditure 1974-75	Forecast of Expenditure 1973-74	Actual Expenditure 1972-73
	Ministry												
2-4	Department	xx,xxx	xx,xxx	x,xxx	xx,xxx	xx,xxx	xxx	xx,xxx	xx,xxx	x,xxx	xx,xxx	xx,xxx	xxx
2-46	Commission	x,xxx	x,xxx	xxx	x,xxx	x,xxx	xx	x,xxx	x,xxx	xxx	x,xxx	x,xxx	xx
2-54	Board	xxx	xxx	xx	xxx	xxx	x	xxx	xxx	xx	xxx	xxx	x

expenditure submitted in the Main Estimates are incomplete, excluding as they do all Supplementary Estimates and all lapses not reflected in the amounts to be voted.

The comparisons on Main Estimates Table 2 are improved by showing changes only in respect of amounts to be voted. Three columns are shown for estimates of expenditure, forecast expenditures, and actual expenditures to indicate the trends in these figures, even though the "estimates of expenditures" column is not fully comparable to the other two in that it omits authorities yet to be requested and any forecast of lapses. Changes should also be made to one other table in the Estimates, namely Table 7 "Major Budgetary Items", to indicate more clearly that the comparisons of "voted" items is between amounts to be voted, and the comparison between statutory items is of estimates of expenditure.

No proposals are put forward in respect of the other tables except that the term "estimates of expenditure", rather than estimates should be used so that there will be no confusion as to the nature of the data being compared with forecast expenditures of the prior year, and actual expenditures of the year prior to that. Nevertheless, it is important to emphasize that the data included under the heading, "estimates of expenditures", should be complete, including amounts expected to be expended under those multi-year appropriations not now included.

Recommendation 8 - *Tables 1 and 2 providing summary data in the front of the Main Estimates book should be revised to show amounts to be voted separately from estimates of expenditure and to show prior year data in a manner that draws more appropriate comparisons with each of these amounts for the Estimates year.*

SUMMARY TABLE IN SUPPLEMENTARY ESTIMATES

Supplementary Estimates provide only a single summary presentation. In this summary the previous Estimates are shown for each department and agency requesting Supplementary Estimates with only one total for both budgetary and non-budgetary loans, investments and advances submitted to date (all others being shown in total). The amounts of Supplementary Estimates, where budgetary, are divided into amounts to be voted and those that are statutory, with the amount of non-budgetary Supplementary Estimates being added to arrive at total Estimates to date. Subsequent Supplementary Estimates commence with the new total of previous Estimates and present the same details in arriving at new totals for Estimates requested to date.

In view of the fact that budgetary expenditures and non-budgetary transactions are now computed quite differently in the Estimates, the former being a reasonably complete presentation of expenditures, and the latter being solely a tabulation of amounts to be voted, the use of a single total in referring to previous Estimates is misleading. If the proposals with regard to the Main Estimates are followed, both amounts to be voted and estimates of expenditures should be carried forward into the Supplementary Estimates summary. Amounts to be voted and upwards revisions of estimates of expenditures to provide for changes resulting from the new authorities requested, as well as changes in statutory and other authorities, should be shown separately with new totals being presented for amounts to be voted and for estimates of expenditures. The proposed presentation is illustrated in Exhibit 6.

The same presentation is appropriate both for budgetary appropriations, and for non-budgetary loans, investments and advances. No total for the two, as in the present summary in the Supplementary Estimates, is suggested since a single total is not generally used in the Main Estimates, quite rightly so since it has little significance.

EXHIBIT 6

Supplementary Estimates (B) 1974-75

SUMMARY OF ESTIMATES FOR 1974-75

Page	Department or Agency	Budgetary						Loans, Investments and Advances					
		Previous Estimates		This Supplementary Estimate		Total		Previous Estimates		This Supplementary Estimate		Total	
		Amounts to be Voted	Estimates of Expenditure	Amounts to be Voted	Estimates of Expenditure	Amounts to be Voted	Estimates of Expenditure	Amounts to be Voted	Estimates of Expenditure	Amounts to be Voted	Estimates of Expenditure	Amounts to be Voted	Estimates of Expenditure

Recommendation 9 - *The summary table in Supplementary Estimates presentations should be revised to present new proposals in terms of both amounts to be voted and estimates of expenditures, and to bring forward and arrive at totals for each of these two amounts, with budgetary appropriations and non-budgetary loans, investments and advances being separately summarized.*

EFFECT OF RECOMMENDATIONS

The recommendations in this chapter should reduce much of the present confusion concerning the nature of the data contained in the Estimates and should result in improved data and improved comparisons of data. The distinction drawn between amounts to be voted and estimates of expenditures may help the average user of the Estimates book to better appreciate the fact that the book contains both requests for authority, and estimates of expenditure.

These recommendations may seem of marginal importance with respect to budgetary appropriations in that there are now relatively few instances where the amount to be voted and the estimates of expenditures will differ. However, in a later chapter we recommend that fund appropriations be classified as budgetary. Since fund appropriations are not annually lapsing, the estimates of expenditures under these authorities will bear no relationship to amounts to be voted from time to time. In respect of non-budgetary loans, investments and advances the recommendations in this chapter will result in a substantial improvement in information presented to Parliament.

It should be recognized, however, that the comparisons of expenditures will be better, but still not fully valid. As long as additional authorities are granted for the fiscal year after the date on which the Main Estimates are prepared, and as long as some appropriations

lapse, there will be differences between the data described as "estimates of expenditure" and forecast and actual data with which it is compared.

This chapter is only concerned with the presentation of summary information in the Estimates. In Chapters 7 and 8 we discuss the detailed accounting for apppropriations. The proposals in this chapter are picked up again in these chapters, and the effect of these recommendations on the Estimates presentation of individual appropriations is illustrated. In addition, since the Estimates presentation governs the presentation of the government's accounts in the Public Accounts to a considerable extent, the impact on the Public Accounts is also discussed at appropriate places elsewhere in this report.

Chapter 4 -

STATEMENT OF ASSETS AND LIABILITIES

The Receiver General for Canada is required to prepare a statement showing such of the assets and liabilities of Canada as in the opinion of the Minister of Finance are required to show the financial position of Canada at the termination of the fiscal year. This statement which is required under the terms of the Financial Administration Act is certified by the Auditor General.

The basis on which the present Statement of Assets and Liabilities is prepared is described in the Public Accounts of Canada as follows:

> "The assets and liabilities of Canada are set out so as to disclose the amount of the net debt. In 1920, the practice was established of offsetting against the gross liabilities only what were designated as 'active' assets in determining the net debt.
>
> In the budget speech of May 18, 1920, the following explanation was given by the Minister of Finance.
>
> > 'Assets which are not readily convertible, as the reserve is convertible, or are not interest producing, are not such assets as ought to be deducted from the gross debt. They are inactive, they are items of such a character as might well be placed in a suspense account. At any rate, whatever may be their future value, however great it may be, they are not assets of such a character as to directly reduce the gross debt any more than the other capital accounts of the country ought to be deducted from it.'"

The gist of the idea of the then Minister of Finance, the Honourable H.C. Drayton, was that the really important part of the Statement of Assets and Liabilities of Canada was the liabilities and that the assets should be arranged in two groups - those "active" items such as cash, readily convertible items and revenue-producing assets in one, and the capital and non-active items, in the other. The active assets could then be deducted from the gross liabilities to yield the

"net debt" of Canada; capital and non-active assets were not to be so deducted but were to be deducted from "net debt" in determining the balance in the "Consolidated Fund".

The Dominion of Canada Statement of Assets and Liabilities of March 31, 1920, can be summarized as follows (in millions of dollars):

ASSETS		LIABILITIES	
Various "active" assets totalling	$ 793		
Balance, Net Debt	2,248	Various liabilites including Funded Debt	$3,041
	$3,041		$3,041
Various capital and non-active assets as listed, totalling	$1,076		
Balance, Consolidated Fund	1,172	Net debt, brought down	$2,248
	$2,248		$2,248

Drayton's views as quoted in the Public Accounts and illustrated in the Statement show that, while he was convinced that capital and non-active assets should not be deducted from the gross debt, he had no hesitation in carrying them on the Statement as "assets". Indeed, they were retained and reported on the Statement for some twenty additional years before being merged into "net debt".

The Drayton concept in its original form was therefore an attempt to show the state of the government's affairs at the end of the fiscal year by disclosing the total of liabilities and thus calculating "net debt" by deducting "active assets" from liabilities. "Net debt" so calculated was a representation of "dead-weight debt",

i.e. debt that could not be repaid from the normal realization of assets. In addition, there was further disclosure of the capital and non-active assets which were deducted from "net debt" to arrive at the balance of the Consolidated Fund. When capital and non-active assets were later written off, the intention of the change was, in principle, to improve the standard of reporting by excluding entirely assets that could not qualify as "active assets".

After the modification of Drayton's original concept resulting from the elimination of capital and non-active assets, many items were recorded as assets that did not meet his standards for "active assets". For example, advances were made that were neither realizable nor interest earning; some loans were made that were equivalent to grants; and expenditures charged to non-budgetary appropriations were recorded as assets until such time as they could be charged to budgetary appropriations. Moreover, the nature of the government's assets altered as the government established new Crown corporations, developed new loan programs, and made loans to foreign governments and international institutions. Because of these changes, it is necessary to determine whether the traditional policy is appropriate, and if not, what alternative statement of policy may better express the practices followed in respect of the Statement of Assets and Liabilities.

The possibility that the government should adhere to a narrow liquidity or realization concept was first considered, but it was concluded that this approach is not sufficiently comprehensive to cover all items that should be reported. In this respect, government does not differ from private enterprise where reporting practices used to be dominated by the concern for liquidity, but where now there is far greater recognition of the fact that most organizations are on-going in nature and liquidity is only one of many concerns in reporting on financial position.

As described in the Introduction, all transactions not reported as budgetary revenues or expenditures are now accounted for as non-budgetary transactions. Non-budgetary transactions, as most broadly defined, are those which increase or decrease the government's asset or liability accounts. Thus one way of determining the purpose of the Statement of Assets and Liabilities is to identify the characteristics that make a transaction properly non-budgetary as compared to budgetary.

The general principle which is proposed in the balance of this chapter is that non-budgetary transactions should be defined as those which give rise to financial claims on or reduce liabilities to parties outside the Government of Canada. As has already been noted, such transactions have grown steadily in importance and there has been a corresponding growth in the importance attached to their proper accounting. In this light, the Statement of Assets and Liabilities may be regarded as possessing enhanced significance as reflecting the government's participation in the total stock of Canadian financial claims.

This chapter first examines the nature of the assets and liabilities which should be recorded on the Government of Canada's Statement of Assets and Liabilities. It then considers the closely related problem of valuation. It concludes with some suggestions for improving the presentation of the Statement of Assets and Liabilities.

DEFINITION OF ASSETS AND LIABILITIES AS FINANCIAL CLAIMS

Consistent with the concept of an accounting entity which presents its accounts in terms of its financial relationships with outside or third parties, the liabilities of the Government of Canada can be defined as its financial obligations to be paid in the future to organizations and individuals, including its employees, outside the defined limits of the organizations making up the government, as a result of

events and transactions prior to the accounting date. Similarly, the assets of the Government of Canada may be defined as the financial claims it has acquired on other organizations and individuals as a result of events and transactions prior to the accounting date. Taken together, the net of financial claims owing by and to the government, is reflected in a balancing figure on the Statement of Assets and Liabilities.

Recommendation 10 - *Assets and liabilities of the Government of Canada should be defined as follows:*

- *assets are the financial claims acquired by the Government of Canada on outside organizations and individuals as a result of events and transactions prior to the accounting date; and*

- *liabilities are its financial obligations to outside organizations and individuals as a result of events and transactions prior to the accounting date.*

Many of the items which now appear on the balance sheet unambiguously meet this test. Examples include most loans, investments and advances to Crown corporations, provincial and municipal governments, foreign governments and international organizations on the asset side, and the bonds and bills outstanding on the liability side. But there are a number of items now reported which less clearly meet the test of being financial claims owing by or owed to the Government of Canada.

There are certain pension and insurance accounts, for example, which require special consideration; these are the Old Age Security Fund, the Unemployment Insurance Account, the Canada Pension Plan accounts, and

the Superannuation Accounts. The extent to which they reflect liabilities to the public is not easy to determine. As a consequence of their size and social significance these accounts have enjoyed special status. These accounts are discussed individually to provide the background necessary to appreciate the recommendations put forward. The treatment of advances under revolving fund authorities and similar balances due from component organizations of the Government of Canada is examined next, since these are now recorded as if they were financial claims to outside or third parties. Accounts receivable, accounts payable and deferred charges and credits are then reviewed.

The Old Age Security Fund

The Old Age Security Fund was established by virtue of the Old Age Security Act, 1951. The fund was created as a separate fund to recognize the ear-marking of certain revenues for purposes of covering old age security payments. The intent was that revenues should cover expenditures, and adjustments, from time to time, would be made to the tax levy to attain this effect.

Receipts of the fund from inception were derived from special personal and corporate income taxes and sales taxes which were not included in budgetary revenue. On January 1, 1972, the levy of special taxes which were credited to the fund was repealed and was replaced by a transfer of funds based on estimates of what the credits to the fund would have been if the taxes had not been repealed.

Payments from the fund are in respect of persons eligible for Old Age Security pensions. Guaranteed income supplement payments, first introduced in 1966-67, are also charged to the fund. These payments are not included in budgetary expenditure. In the 10-year period ending in 1973-74, tax receipts have increased by 260 percent from $960 million in

1964-65 to some $2.5 billion in 1973-74. Pension payments in the same period increased more dramatically from a level of $885 million in 1964-65 to $3,035 million in 1973-74 for an increase of over 340 percent.

The balance in the fund peaked in 1970-71 and at March 31, 1971, stood at $728.4 million. In the following three years, benefit payments exceeded receipts by $930 million and in 1973-74, there was a budgetary appropriation of $235 million to keep the fund in a credit position. Barring any change in legislation, benefit payments are expected to continue to be greater than receipts thus requiring an annual budgetary allocation to the fund to keep it solvent. Accordingly, there is no remaining balance in the fund which could be regarded as a liability to persons outside the Government of Canada.

During the course of our study, legislation was passed which eliminated this fund. As of July 1975 Old Age Security transactions will be treated as budgetary rather than non-budgetary. This treatment is in accordance with the accounting principles advocated in this report, since there is no separate third party funding of these transactions.

The Unemployment Insurance Account

The treatment of transactions with respect to Unemployment Insurance in the Public Accounts has undergone a series of changes in the past five years. These have resulted in dramatic changes in accounting treatment which have had significant effect on the Statement of Assets and Liabilities.

The growth rate in both employer/employee contributions and government contributions as well as benefit payments has been notable in the past five years. This has been especially true since the

introduction of the revision to the Unemployment Insurance Act in June 1971. Employer/employee contributions more than doubled in the 5-year period ending in 1973-74 and were in excess of $1 billion in 1973-74. The government contribution went from just under $100 million in 1969-70 to over $850 million in 1973-74. Benefit payments went from $0.5 billion to $2.0 billion during the same period.

It is important to note that the Unemployment Insurance Commission is now reimbursed for benefit payments in two different forms. In the first instance, benefit payments in respect of fishing benefits, payments related to the Adult Occupational Training Act, extended benefits and those initial benefits resulting from unemployment in excess of four percent, are all reimbursed directly by the government. All other benefits and other costs are borne by the Commission and are financed through contributions from employers and employees. Any temporary deficiency in the private sector portion is financed through an interest-bearing loan to the Commission.

Under the current treatment there is a time lag before the Unemployment Insurance Commission is reimbursed for costs to be borne by the government. Payments for a given calendar year are made two quarters after the termination of the calendar year. The effect of this time lag is two-fold. In the first instance, the budgetary expenditure for any given period, whether on a monthly or fiscal-year basis, is seriously distorted. Secondly, as a direct result of the time lag, the government must make temporary advances to the Commission to meet these costs. These advances are non-interest-bearing and are recorded as assets on the government's Statement of Assets and Liabilities. Since these advances can be recovered only through a subsequent charge to budgetary expenditure, the Auditor General has questioned their authenticity.

The major argument which was advanced for the current treatment was that by introducing the time lag, the government's contribution for the year in question would not appear in the Main Estimates except on an ex-post basis. This reflected the inherent difficulties in making accurate forecasts of the level of unemployment. If one considers the many factors which influence the government's cost, it is not clear that the current treatment is still justifiable. But, if the argument originally put forward is still considered valid, the Main Estimates figure could be based simply on the then current level of unemployment, and be revised in final Supplementary Estimates. The payments, of course, are statutory in nature.

To eliminate the problems encountered in the current treatment, the government contributions, as estimated on a monthly basis, should be recorded as budgetary expenditures rather than as interest-free advances to the Unemployment Insurance Commission. In addition, any advances to the Unemployment Insurance Account for working capital and similar purposes should be treated as part of the government's contributions. In this manner, budgetary expenditures on both a monthly and fiscal-year basis would become more meaningful. Such a treatment would also have the effect of eliminating these advances as assets of the Government of Canada.

The current treatment of the fishing benefits gives rise to a minor inconsistency. The fishing benefits, unlike other benefits, are charged to budgetary expenditures directly. For the sake of consistency, fishing benefits, like other benefits, should be charged directly to the Commission in the first instance with the government contributions reimbursing these and all other costs assumed by the government.

The adoption of the above proposals would mean that at the end of any given fiscal year, the balance on the government's Statement of Assets and Liabilities with respect to the Unemployment Insurance Account

would consist of the interest-bearing advances to the Account which represent the deficit or the surplus in the Account with respect to the private sector. This may properly be regarded as a claim on or a liability to the contributors.

Recommendation 11 - *The Unemployment Insurance Commission should be reimbursed by the government on a monthly basis for all expenditures to be borne by the government. Such reimbursements should be recorded as budgetary expenditures of the period to which they pertain, thus deleting non-interest-bearing advances from the Statement of Assets and Liabilities.*

Government superannuation accounts

The purpose of the various government superannuation accounts is to provide pensions to retired employees or their dependants.

Receipts to the accounts stem from several sources, the major ones being:

- contributions by employees based on a percentage of their salary;
- a matching contribution by the government;
- interest paid on the balance of the account;
- a contribution by the government to cover deficiencies including, for example, those caused by a general increase in the level of salaries; and
- transfers from other pension funds.

The disbursements stem from:

- immediate and deferred annuities;
- return of contributions; and
- transfers to other pension funds.

The three major pension accounts of the government have credits far in excess of their disbursements. This excess of amounts credited over disbursements constitutes the single most significant credit in non-budgetary transactions. It has more than tripled in the past 10 years and currently exceeds a billion dollars.

It could be argued that the pension accounts should be deleted from the Statement of Assets and Liabilities. Under this treatment, the liabilities would be recorded as contingent, and only the benefits paid out would be regarded as budgetary expenditures. This approach is not recommended. The liabilities of the superannuation accounts can reasonably be regarded as liabilities to third parties and there is no doubt that the deletion of these accounts would be strongly opposed by both the employees and their unions.

The contributions by the government to cover deficiencies is based on two calculations: first, an actuarial review which is carried out annually to compute the effect of authorized increases in salaries, and second, a quinquennial review which takes into account changes in retirement provisions, mortality and other information that becomes known only as the five-year period passes. The estimated amount to be borne by the government is added to the liability account, and the offsetting cost is carried as an asset until it is written off to budgetary expenditure. The actuarial adjustments credited to a particular pension account are written off to budgetary expenditure evenly over a 5-year period.

It might be argued that the current method of amortizing actuarial liabilities, which gives rise to deferred charges, should be discontinued since these are not financial claims on third parties. The current method could be replaced by a procedure which would recognize as a charge to budgetary expenditure the whole of the liability as soon as it is determined. This procedure would eliminate the deferred charges. However, the current treatment is similar to the procedures used by the private sector, and more importantly, results in a charge to budgetary expenditure which is at least closer to that which would result if the liability could be computed annually. This is a departure from the general principle that assets should represent claims on third parties, and liabilities should represent obligations to third parties. While we do not recommend any change to the present method of amortizing the actuarial deficiencies, we do recommend that the deferred charge be shown on the liability side of the Statement of Assets and Liabilities as a deduction from the liabilities for superannuation. This change in presentation has the advantage of bringing together on the Statement all balances affecting superannuation.

The Canada Pension Plan

The plan was established under legislation enacted in 1965. It was designed to provide an organized program for retirement pensions for members of the labour force. It also provides benefits to a disabled contributor as well as death benefits for his or her spouse and children.

All funds received by the plan, which are not required to meet expenses and payments of benefits during the following three months, are made available for purchase of provincial securities. The amount offered to each province is proportional to the cumulative total of contributions paid in each province. Any funds not borrowed by the provinces, together with funds collected in the Yukon and Northwest Territories, are invested in securities of the Government of Canada.

The receipts of the plan from employer/employee contributions, investment income and other sources are credited to the Canada Pension Plan Account in the Consolidated Revenue Fund. Disbursements for benefit payments and administration expenses are charged to this account. The balance of the account currently appears on the liability side of the Statement of Assets and Liabilities. The purchase of securities is debited to a separate account in the Consolidated Revenue Fund, namely the Canada Pension Plan Investment Fund. This Fund currently appears on the asset side of the Statement.

Since inception, the plan has accumulated a large surplus. At March 31, 1974, the balance in the Canada Pension Plan Account amounted to $6,934 million. Of this amount $6,796 million had been used for the purchase of federal and provincial securities, with the balance remaining in the government's cash balances.

No change in the structure of the Canada Pension Plan or in the accounts maintained in the Consolidated Revenue Fund to record the transactions of the plan is advocated since these are indeed liabilities to or claims on third parties. However, a change in presentation is proposed later in this chapter so that the provincial government securities held by the Investment Fund are offset against the liabilities shown for the Canada Pension Plan.

Advances to revolving funds, working capital advances and similar accounts

Because of the practice of treating expenditures under revolving funds and similar authorities as non-budgetary advances, the Statement of Assets and Liabilities now treats such advances as assets even though they have been used to acquire fixed assets, inventories and for other purposes that would normally be treated as expenditures, not assets. This results in a financial claim, but one that is recoverable by the Government of Canada in most circumstances only from itself. This treatment is not in accordance with the concept of an accounting entity

reporting in terms of amounts due to and from third parties. In a later chapter, where the subject of fund appropriations is dealt with more fully, recommendations are put forward to treat such advances as budgetary expenditures. Accordingly, any balances should be eliminated from the Statement of Assets and Liabilities.

Undisbursed balances of appropriations to special accounts

A limited number of appropriations authorize a credit to a special account to be treated as an expenditure. As a result, undisbursed balances are carried forward as liabilities of the Government of Canada. These are not claims owing to anyone, particularly a third party outside the Government of Canada; they are unutilized authorities which may warrant an appropriate note in the Public Accounts. It is recommended later in the chapter that the present practice of treating them as liabilities on the Statement of Assets and Liabilities should be discontinued.

Accounts receivable

Accounts receivable may be regarded as financial claims owing by third parties to the Government of Canada, and accordingly should be considered for inclusion as assets on the Statement of Assets and Liabilities.

By far the greater part of unrecorded receivables is represented by taxes not yet paid. Of those assessed, but unpaid, a substantial portion are under appeal. At the same time there may be a significant amount of taxes due but yet to be assessed. Estimating the reduction arising from appeals and the increase from future assessment would be a complex task, and one which would reap few benefits in view of the fact

that the revenue departments already have these accounts under good control. As a result, it was concluded that there would be little advantage in including taxes receivable on the Statement of Assets and Liabilities in view of the major problems in determining and valuing such assets.

Accounts receivable arising as a result of various services rendered by government departments are more difficult to control. Many of these amounts are relatively small. While these accounts should be kept under good accounting control, few additional benefits would be derived from recording them on the Statement of Assets and Liabilities. Most governments traditionally account for revenue on a cash basis, because such revenue does not become available for use until it is collected. Under the concept of the Consolidated Revenue Fund, all revenues are pooled, and funds are not ear-marked for specific purposes. Although the cash method of accounting for revenue differs from practices proposed on the expenditure side which involve recording accounts payable, we see no reason for departing from the cash basis of accounting for both tax and non-tax revenue because much of the revenue is not susceptible to accrual, is difficult to measure until it is collected, and of course does not become available until that time.

Accounts payable and accrued liabilities

The liabilities for items coming in course of payment at the end of the fiscal year are now recorded only if they are discharged within the 30-day period after the fiscal year-end. The recording of a liability is thus dependent on whether spending authority is available and administrative procedures permit the issue of a cheque within the 30-day period. Proposals are made later in this report to require all accounts coming in course of payment during a fiscal year to be charged to an appropriation even if authority is exhausted. This should result in all financial claims being set up as accounts payable at the fiscal year-end.

Interest due and outstanding is recorded as it becomes payable, and in addition the liability for accrued interest and salaries and wages is recorded. No changes are proposed in respect of these practices.

Deferred charges and credits

Deferred charges include the unamortized portion of actuarial deficiencies in the various superannuation accounts, which has already been discussed, and unamortized loan floatation costs, including discounts and commissions. The practice of amortizing such costs over the life of the related debt is a departure from the principle of recording only financial claims. This practice seems unnecessary and should be discontinued. Such loan costs should be charged to budgetary expenditures in the fiscal period in which they are incurred.

Deferred charges now include the unamortized portion of any discounts on Treasury bills. These bills are included in unmatured debt at their face value, and discounts are amortized by charges to budgetary expenditures over the term of the bills. This is consistent with the practice of charging interest to budgetary expenditures as it becomes due rather than when it is paid. Although we do not recommend any change in this practice, we believe that any unamortized balances should be reported with interest payable.

Deferred credits result from the practice of including in the value of loans, investments and advances the amounts of interest due but not received. This practice results in the government's financial claim being recorded, while the deferral of interest is in keeping with the practice of not reporting revenues until cash is received. This accounting practice appears appropriate, but the government's financial position would be portrayed more accurately if these deferred credits were shown as deductions from the assets to which they pertain, rather than as liabilities. Deferred credits also include unamortized premiums; these should be taken into the accounts in the current period in the same manner as discounts should be charged to expenditures.

Recommendation 12 - *Consistent with the definition of assets and liabilities previously recommended, the following should be deleted from the Statement of Assets and Liabilities:*

- *working capital advances and revolving funds except for those primarily used to record financial claims on organizations and individuals outside the Government of Canada;*

- *undisbursed balances of appropriations to special accounts; and*

- *deferred loan amortization costs and premiums.*

TREATMENT OF INVENTORIES AND CAPITAL ASSETS

Capital assets

The present Statement of Assets and Liabilities omits any value for capital assets because costs of capital works are charged to expenditures at the time of acquisition or construction. Consequently government buildings, public works, national monuments, military assets (such as aircraft, naval vessels and army equipment) and other capital works and equipment are recorded on the Statement of Assets and Liabilities at a nominal value of $1.00. These capital works are regarded as "collective assets" and are part of the infrastructure of the government.

It would of course be easy enough to treat the acquisition of certain specific classes of fixed capital assets as non-budgetary and add them to the Statement of Assets and Liabilities, but very serious problems of valuation would arise. In the first place, it would be necessary to make some provision for depreciation. In the second place,

it might be necessary to provide for revaluations from a depreciated historical cost basis to replacement cost or some other measure of current value. The experience of private enterprise accounting in periods of rapid change in price levels suggests, though it may well understate, the difficulties which would be encountered by governments. The underlying concepts of government accounting require only that the acquisition of capital assets should be properly authorized and recorded at the time of acquisition. It is difficult to see what further purposes could be served which would justify incurring these difficulties of valuation. Only in limited cases can the benefits deriving from the valuation of such assets be computed in such a way as to permit a meaningful calculation of the rate of return on them. For purposes of management control, a record or inventory of physical assets is more useful than uncertain dollar values alone. If the proposals contained in the chapter on fund appropriations are adopted, revolving funds could be used to finance major capital acquisitions and thereby improve the accounting for capital assets, but such assets should not be set up directly or indirectly as assets of the Government of Canada on the Statement of Assets and Liabilities.

Inventories

A less clear-cut case can be made in the area of inventories since there are fewer problems of valuation. Inventories are incidental to most government organizations. While their existence may affect future expenditures and costs, the impact on the Consolidated Revenue Fund and supplying companies occurs when they are acquired not when they are used. Few benefits would be derived from recording such values on the government's Statement of Assets and Liabilities.

Knowledge of the amounts of expenditures tied up in inventories provides a useful measure of managerial decisions and the economies of buying in advance. Their usage should be reflected in costs. As with fixed assets, the use of fund appropriations will facilitate the management of inventories wherever their amounts are significant enough to warrant such authorities being used.

VALUATION OF ASSETS AND LIABILITIES

The basic method of valuing the assets and liabilities of the Government of Canada is at cost, although there are some exceptions to this practice. The questions to be answered are whether this valuation is properly informative in showing the financial position of the Government of Canada and whether a valuation on some other basis than cost is possible using reasonably objective criteria for this purpose.

Several questions have to be posed. First, should assets and liabilities be both written up and written down from their cost to arrive at their true economic value? Second, should this be done by changing the value at which they are recorded or should provisions be made by reserves to qualify the values at which assets continue to be carried on the books? Third, how should the offset to the revaluation reserves be accounted for, by an item included in budgetary expenditures or revenues or by an entry directly to net debt? Finally, based on the decision made in this respect, what is the nature of the accounting that should take place when the value of an asset or liability is subsequently changed?

Certain assets such as loans never increase in value, although their value may be reduced. Others, such as an equity investment may both increase and decrease. The same may be true of foreign exchange

assets and liabilities. Ideally, the government's Statement of Assets and Liabilities should come as close as possible to reflecting the true economic value of the assets and liabilities recorded on it. Therefore, wherever increases and decreases in values are equally within the competence of the government's accountants to compute objectively, both should be reflected in any valuation adjustments.

In some instances, these conditions for adjusting the values of specific assets or liabilities are not met, but there may be a measurable probability of some change in the values of a class of assets or liabilities. The use of a provision or reserve in these cases is appropriate. This practice also avoids labelling a specific claim as one likely to go unpaid. Through use of reserves in areas of uncertainty or sensitivy, the Government of Canada can report its financial position fairly without waiting until there is a conclusive case for a valuation adjustment.

Any change in value of either assets or liabilities must ultimately be reflected in an off-setting entry in the account recording the balance between the two. Valuation adjustments and provisions to create reserves should be treated as budgetary expenditures or revenues. Where a reserve is created, any subsequent valuation adjustment should be made against this reserve. In all cases direct charges or credits to the account representing the balance between the assets and liabilities should be avoided, except in those very rare cases where a fundamental change occurs in practices, and in effect, the accounts of previous years are being restated.

We now consider the application of these practices to various types of assets and liabilities recorded on the Statement of Assets and Liabilities.

<u>Financial claims other than those owing by corporations controlled by Canada</u>

Most financial claims are in the nature of loans and advances. Claims, other than those of an equity nature, cause few problems in terms of upward revaluations because the maximum amount recoverable is usually fixed. However there are several circumstances in which such claims may not be paid in full.

The Government of Canada acts as a financial intermediary to attain many of its objectives vis-à-vis international organizations, other national governments, provincial and municipal governments, business and non-profit enterprises and individuals. Often it provides loans or advances which contain conditions relative to payment of interest or repayment of principal that have potential characteristics of a grant. Normally, however, such conditions are not recognized in the accounts until the creditors earn the right to such forgiveness. Since it is obviously the government's intention that the recipients will earn such forgiveness, it is questionable whether recognition of such costs should be so deferred. Obviously, the full value of the loans should be carried on the government's books until the necessary conditions are met, but the probable charge to budgetary surplus or deficit should be recognized at the time advances are made by creating reserves equal to the expected forgiveness. This practice is now followed in respect of the Veterans' Land Act, but this is an exception rather than the general rule.

Not all forgiveness takes place at the time a loan is made. Sometimes the government may alter repayment terms at some later date. In this event, a provision should be made to increase the reserve to the amount which will reflect the new terms.

A loss of value may also occur as a result of the inability of creditors to repay their debts to the government. Where there is sufficient past experience to indicate the amounts of probable losses, reserves should be created for this purpose. Such reserves should be restricted to loans to organizations and individuals, and exclude loans to other governments. Past experience is of limited relevance in the case of governments which normally seek to negotiate changes in repayment terms if they encounter difficulties.

A number of loans and advances have been made at interest rates which were lower than those paid by the government at that time. In other cases, the loans may have reflected interest rates at the time they were made, but such historical rates bear little relationship to current debt costs. It is not recommended that these loans be discounted to their present value at current interest costs because this would be anticipating future debt costs which are often unpredictable and which may or may not be incurred depending upon the government's overall financial requirements at that time. Furthermore, to do so, consistency would require the government's own debt to be revalued at current interest rates. Neither of these exercises would produce particularly useful information since the government does not allocate interest costs to most programs and generally accounts for its debt costs as they accrue or are paid.

In the case of both reserves to allow for forgiveness clauses and the reserves to provide for probable losses, the legislation authorizing the loans should provide authority for the reserves. The estimated amount of such reserves on new loans granted in the Estimates year should be included as budgetary expenditures in the Estimates of the responsible department as a statutory item, as well as in the Public Accounts of the year concerned. Where this is done, the amounts included

in the Estimates, as estimates of expenditure under the Loans, Investments and Advances heading, should show both gross expected expenditures and a credit equal to the amount of the reserve included in budgetary expenditures. This avoids any double counting. The initial provision of the reserves should be made under the authority provided to the Minister of Finance under Section 54 of the Financial Administration Act.

> Recommendation 13 - *Reserves should be established against specific classes of domestic loans and advances to reflect conditional forgiveness clauses, and in the case of loans and advances to non-governmental organizations or to individuals, amounts required to provide for that portion of the total loans, which based on past experience, are not likely to be repaid.*

Loans, investments and advances to government controlled organizations

The government makes a variety of forms of advances to Crown corporations and other corporations which it controls. These may take the form of investments in equity, general purpose loans, or loans for specific purposes. These advances are carried in the accounts of Canada at the value of amounts advanced. Increases in the value of equity interests are not recorded, any amounts received from the corporations being treated as revenue at the time they are received.

Volume I of the Public Accounts contains a schedule comparing the values recorded in the accounts of Canada with the values recorded in the corporations' own accounts. Volume III contains the audited financial statements of most corporations. Neither the accounts of Canada nor the corporations' own accounts present current economic values, but there is adequate disclosure of their accounts along conventional lines.

There are certain Crown corporations, however, where it is obvious that the corporations do not have sufficient revenue sources to repay their outstanding loans except through parliamentary appropriations. The government has already indicated that it will discontinue the practice of treating advances to the National Capital Commission and to the Canadian Broadcasting Corporation as loans, and that it will write-off existing loans. This new approach appears to be more appropriate in that, under our proposals for accounting for Schedule C and D corporations, these amounts would otherwise be recorded as financial claims of the Government of Canada.

Little value would be derived by the Government of Canada attempting to make specific provisions annually to adjust the value of its investment in all Crown corporations either upwards or downwards. The accounts of the individual corporations are themselves not stated at current values. This is not to say, however, that the government should not take action to cause a capital reorganization of those corporations whose financing is completely unrealistic, and adjust its own investment accordingly, so that its investment and the capital of the corporations will provide a realistic base against which to measure future operating results.

Foreign exchange accounts

While cash holdings of foreign currencies are converted to market value, the holdings of foreign securities, Special Drawing Rights, and gold are valued at historical cost, with a notation as to their current market value. Liabilities payable in foreign currency are valued at historical cost.

In our view, this is an area where both upwards and downwards revisions in values would be appropriate and where the appropriate practice would be to adjust the recorded values rather than to establish

reserves. Moreover, a policy is required that would not result in short-term fluctuations unduly affecting the budgetary surplus or deficit. It is understood that proposals are being considered which would have this effect and therefore we do not believe it is necessary to make recommendations on this subject.

Treatment of existing reserve for losses on realization of assets

The Statement of Assets and Liabilities now includes a reserve of $546,384,065 created by lump-sum charges to budgetary expenditures during the period from 1941 to 1957, less amounts written off in the same period. Over the period from 1941 to 1947 an annual provision of $25 million was made and this was increased to $75 million in the years from 1948 to 1952. The practice of making an annual provision was discontinued after 1952, except that an amount of $50 million was provided in 1957. During the period when annual provisions were being made, assets were written off to the reserve, but since 1957 there has been no change in the balance.

This reserve while providing to some extent for over-valuations of assets has never been related to specific assets. After providing for the specific reserves proposed in this report, any balance should be eliminated at the same time as the other adjustments that may be required as a result of recommendations in this report, the net amount to be charged or credited to the account representing the balance between the recorded assets and liabilities of the Consolidated Revenue Fund.

We considered the possibility of regular charges to budgetary expenditures each year to provide for unforeseen future changes in values. However, it was felt that such a provision for a general reserve would

be very arbitrarily arrived at, and that it would be better to charge adjustments to the budgetary surplus or deficit of the year in which they take place or to "net debt", as may be most appropriate depending on the size of and reasons for the adjustments.

Recommendation 14 - *The present reserve for losses on realization of assets should be used to provide for any specific reserves that may be required, with any balance being written off after arriving at the budgetary surplus or deficit of the year along with such other adjustments that may be required at the time of implementation of proposals in this report.*

PRESENTATION OF ASSETS AND LIABILITIES

In this chapter a number of changes in accounting treatment have been recommended, or note has been taken of other changes which have been or are in the course of being proposed by the government. If these changes had been put into effect as of March 31, 1973, the amounts of total assets, total liabilities and the balance between the two as reported on the Statement of Assets and Liabilities would have been significantly different. Among the changes would have been elimination of the following assets and liabilities:

- loans for which parliamentary appropriations are required, including the non-interest-bearing loans to the Unemployment Insurance Commission which are recoverable from budgetary appropriations;

- loans and working capital advances to departments and agencies falling within the defined limits of the Government of Canada;

- the liability to the Old Age Security Fund;

- umamortized premiums and discounts in connection with the sale of government bonds;

- undisbursed balances of appropriations; and

- the reserve for losses on realization of assets.

The effects of these changes on the Statement of Assets and Liabilities are displayed on Exhibit 7. In addition to these changes, but not displayed on the Exhibit, are any reserves which would be required for purposes of making provision for losses on specific loans and other assets where recovery is doubtful. No attempt has been made to estimate these amounts.

One additional change in accounting treatment is proposed - this is to present liabilities on the basis of amounts owing to third parties. The Statement of Assets and Liabilities currently presents the government's liabilities in terms of the gross amounts repayable, irrespective of whether the liabilities are offset by securities held in trust or government holdings of its own securities. In order to inform the reader more clearly and to avoid overstating the amount of the Government of Canada's liabilities to third parties, the liabilities should be presented to show the gross amounts repayable less reductions by way of internal holdings of like or similar claims. This presentation would require:

- the value of securities held in trust to be presented as a reduction in determining the net liability due to others in the case of trust accounts, annuity accounts, insurance accounts and pension accounts;

- the Government of Canada's holdings of its own bonds and Treasury Bills being presented as a reduction of the liability.

EXHIBIT 7

GOVERNMENT OF CANADA

STATEMENT OF LIABILITIES AS AT MARCH 31, 1973

STATEMENT IN CURRENT FORMAT

		$ Million
Current and Demand Liabilities		
(a) Outstanding cheques		751 2
(b) Accounts payable (that portion paid in April of the next following year)		745 9
(c) Non-interest-bearing notes payable to international organizations		84 4
(d) Matured debt outstanding		35 5
(e) Interest due and outstanding		842 3
(f) Interest accrued		584 6
(g) Other current liabilities		131 1
		3 175 0
Foreign Exchange Reserve Fund		
(a) Non-interest-bearing notes payable to the International Monetary Fund		853 0
(b) Allocation of Special Drawing Rights in the International Monetary Fund		370 3
		1,223 3
Deposit and Trust Accounts		614.0
Deposit accounts	456 4	
Trust accounts	159 7	
Annuity, Insurance and Pension Accounts		
(a) Social security accounts —		
Canada Pension Plan		5,793 0
Old Age Security Fund		335 8
(b) Superannuation accounts		9,554 1
(c) Other		1,445 6
		17,128 5
Undisbursed Balances of Appropriations to Special Accounts		187 5
Provision for Compound Interest on Canada Savings Bonds		81 1
Deferred Credits		263 2
Deferred interest on domestic loans	160 0	
Deferred interest on foreign loans	101 3	
Unamortized premiums on loans	1 9	
Suspense Accounts		4 4
Unmatured Debt		
(a) Bonds		24,748 5
(b) Treasury bills		4,290.0
		29 038 5
Total Liabilities		51 715 5

STATEMENT AFTER GIVING EFFECT TO ACCOUNTING CHANGES PROPOSED

		$ Million
Current and Demand Liabilities		
(a) Outstanding cheques		751 2
(b) Accounts payable		745 9
(c) Non-interest-bearing notes payable to international organizations		84 4
(d) Matured debt outstanding		35 5
(e) Interest due and outstanding		842 3
(f) Interest accrued		584 6
(g) Other		
Outstanding Unemployment Insurance warrants		48 9
Outstanding Post Office money orders		38 4
Accrued salaries and wages		37 6
Other current liabilities		6 2
		3 175 0
Foreign Exchange Reserve Accounts		
(a) Non-interest-bearing notes payable to the International Monetary Fund		853 0
(b) Allocation of Special Drawing Rights in the International Monetary Fund		370 3
		1 223 3
Deposit and Trust Accounts		
Deposit and trust accounts		614 0
Less Securities and deposits held in trust		143 1
		470 9
Annuity, Insurance and Pension Accounts		
(a) Canada Pension Plan		5,793 0
(b) Superannuation accounts		9,554 1
(c) Other	1,445.6	
Less Securities held in trust	0 6	1,445 0
		16,792.1
Provision for Compound Interest on Canada Savings Bonds		81 1
Suspense Accounts		4 4
Unamatured Debt Outstanding		
(a) Bonds		24,748 5
(b) Treasury bills		4,290 0
		29 038 5
Less. Bonds and Treasury Bills held by the Government of Canada	40 2	
Government of Canada securities held by Canada Pension Plan	34.5	74 7
		28 963 8
Total Liabilities		50 710 6

EXHIBIT 7

GOVERNMENT OF CANADA

STATEMENT OF ASSETS AS AT MARCH 31, 1973

STATEMENT IN CURRENT FORMAT

		$ Million
ASSETS		
Current Assets		
(a) Cash (includes deposits in trust of $1 3)		2 328 4
(b) Securities held for the securities investment account –		64 2
Bonds and Treasury bills held by the Government of Canada	[illegible]	
Instalment purchase of bonds	[illegible]	
(c) Other current assets		78.0
		2 471 6
Departmental Working Capital Advances		390 1
Financial claims	36 1	
Other	354 0	
Foreign Exchange Reserve Accounts		
(a) Exchange Fund Account		5 641 3
(b) Canada's subscription to capital of the International Monetary Fund		1,192 2
		6,833 5
Social Security Accounts		
Canada Pension Plan investment fund		5 589 6
Unemployment Insurance Account – Advances – all or part to be recovered by parliamentary appropriations		1 474 9
Unemployment Insurance Account		22 4
		7 086.9
Advances, Loans and Investments – Domestic		
(a) Loans to, and investments in, crown corporations		12,608.8
Recovery likely to require parliamentary appropriations		188 2
(b) Loans to provincial governments		682 7
(c) Municipal Development and Loan Board advances		244 6
(d) Veterans Land Act fund (less reserve for conditional benefits)		505.2
(e) Miscellaneous		588.9
		14 818 4
Advances, Loans and Investments – External		
(a) Loans to National Governments		1,641.8
Special loan assistance – international development associations	24 7	
Other loans to National Governments	1,617.1	
(b) Subscriptions to capital of and working capital advances and loans to international organizations		410 8
		2 052 6
Securities held in Trust		118 4
Deferred Charges		
(a) Unamortized portion of actuarial deficiencies –		
Canadian forces superannuation account		376 9
Public Service superannuation account		382.7
Royal Canadian Mounted Police superannuation account		23.5
(b) Unamortized loan floatation costs		158.7
Treasury bills	38.5	
Other	120.2	
		939 8
Capital Assets		–
Inactive Loans and Investments		94 8
Total Recorded Assets		34,808 1
Less Reserve for losses on realization of assets		548.4
		34 259 7
Excess of recorded liabilities over net recorded assets		17,455 8
		51,715 5

STATEMENT AFTER GIVING EFFECT TO ACCOUNTING CHANGES PROPOSED

		$ Million
ASSETS		
Current Assets		
(a) Cash		2 328 1
(b)		
(c) Other current assets		78 0
		2 406.1
Loan Accounts		36.1
Foreign Exchange Reserve Accounts		
(a) Exchange Fund Account		5,641 3
(b) Canada's subscription to capital of the International Monetary Fund		1,192 2
		6 833 5
Social Security Accounts		
Canada Pension Plan investment fund		5,555 1
Unemployment Insurance Account -- Interest-bearing advances		310.0
		5 865.1
Advances, Loans and Investments — Domestic		
(a) Loans to, and investments in, Class C and D crown corporations		12,608 8
Less Deferred credits		160 0
		12 448.8
(b) Loans to provincial governments		682.7
(c) Municipal Development and Loan Board advances		244 6
(d) Veterans Land Act (less reserve for conditional benefits)		505.2
(e) Miscellaneous loans		588.9
		14,470.2
Advances, Loans and Investments — External		
(a) Loans to National Governments		1,641.8
Less. Deferred credits		101.3
		1,540.5
(b) Subscriptions to capital of and working capital advances and loans to international organizations		410 8
		1,951.3
Deferred Charges		
(a) Unamortized portion of actuarial deficiencies –		
Canadian forces superannuation account		376.9
Public Service superannuation account		382 7
Royal Canadian Mounted Police superannuation account		23 5
		783 1
(b) Unamortized discount on Treasury bills		36 5
		819 6
Capital Assets		–
Inactive Loans and Investments		94 8
Total Recorded Assets		32,476 7
Excess of recorded liabilities over net recorded assets		18,233.9
		51,710 6

These changes are also reflected in the second column on both pages of Exhibit 7.

A more substantive departure from the traditional grouping of assets and liabilities is illustrated in Exhibit 8. The main advantages of this presentation are:

- assets and liabilities are grouped in a manner which makes it easy to relate to changes in cash flows as presented on the Statement of Transactions illustrated in Exhibit 1;
- certain assets and deferred charges are offset against liabilities to which they closely relate even though there may be no legal right of set-off, - for example, the unamortized amounts of actuarial deficiencies on account of superannuation are deducted from the gross liabilities to which they relate; and
- certain assets and liabilities whose amounts are determined in terms of foreign currencies are shown separately.

The main disadvantages of this presentation are:

- it fails to show the total liabilities of the government;
- it fails to provide a gross statement of current liabilities;
- it offsets assets against liabilities even though there is no legal right of set-off.

The presentation is designed to show the relationships between the stock and flow of funds as reported on the Statement of Assets and Liabilities and Statement of Financial Transactions respectively. It is recognized

that this is a substantive departure from traditional practices which adhere more closely to the actual legal relationships between assets and liabilities.

Recommendation 15 - *The following changes should be made to the presentation of the Statement of Assets and Liabilities:*

- *all internally held indebtedness of the Government of Canada should be shown as a reduction of the government's liabilities, not as assets of the Government of Canada;*

- *similar types of outstanding payment instruments should be reported together;*

- *deferred credits should be deducted from domestic and external advances, loans and investments, because they have the nature of a reserve against these claims;*

- *assets due from and liabilities due to Crown corporations which primarily engage in banking, lending and insurance activities should be shown separately from those relating to other Crown corporations;*

- *assets and liabilities should be grouped in a manner which makes it easy to relate to changes in cash flows;*

- *certain assets, such as deferred charges, should be offset against liabilities to which they relate; and*

- *certain foreign assets and liabilities should be grouped separately.*

EXHIBIT 8

GOVERNMENT OF CANADA

STATEMENT OF ASSETS AND LIABILITIES

AS AT MARCH 31, 1974

	Balance March 31/74	Net Increase or Decrease (–)	Balance March 31/73
		($ Million)	
ASSETS			
Loans, investments and advances			
Crown corporations and agencies			
Lending institutions			
Central Mortgage and Housing Corporation	6,544	375	6,169
Export Development Corporation	694	142	552
Farm Credit Corporation	1,421	170	1,251
Municipal Development Loan Board	235	– 10	245
Other	60	–	60
	8,954	*677*	*8,277*
All other crown corporations			
Air Canada	254	–	254
Atomic Energy of Canada Limited	754	62	692
Canadian National Railways	2,527	205	2,322
Other	1,279	108	1,171
	4,814	*375*	*4,439*
Other Loans			
Finance	393	108	285
Regional Economic Expansion	417	60	357
Canada Development Corporation	262	75	187
Loans to developing countries	754	183	571
Unemployment Insurance Commission	245	– 65	310
Miscellaneous	1,967	– 37	2,004
	4,038	*324*	*3,714*
TOTAL LOANS, INVESTMENTS AND ADVANCES	*17,806*	*1,376*	*16,430*
Other assets			
Cash in transit	*1,261*	*854*	*407*
Foreign assets (See note 3)			
Exchange Fund accounts	5,466	– 175	5,641
Subscriptions, loans and advances			
International Monetary Fund	1,297	105	1,192
Other international organizations	561	125	436
	1,858	*230*	*1,628*
TOTAL FOREIGN ASSETS	*7,324*	*55*	*7,269*
Cash balances	*810*	*– 1,189*	*1,999*
TOTAL FINANCIAL ASSETS	*27,201*	*1,096*	*26,105*
Capital assets (See note 4)			
NET RECORDED ASSETS	27,201	1,096	26,105
Excess of recorded liabilities over net recorded assets	19,794	1,561	18,233
TOTAL	46,995	2,657	44,338

	Balance March 31/74	Net Increase or Decrease (–)	Balance March 31/73
		($ Million)	
LIABILITIES			
Annuity, insurance and pension accounts			
Canada Pension Plan Account	6,934	1,141	5,793
Less: Provincial government securities in Investment Fund	6,655	1,100	5,555
	279	*41*	*238*
Superannuation and other pension accounts (See note 1)			
Superannuation and other pension accounts	10,849	1,295	9,554
Less: Unamortized portion of actuarial deficiencies	1,090	307	783
	9,759	*988*	*8,771*
Government annuities	1,272	– 19	1,291
Other	175	20	155
TOTAL ANNUITY, INSURANCE AND PENSION ACCOUNTS	*11,485*	*1,030*	*10,455*
Other liabilities			
Interest and matured debt (See note 2)	1,801	294	1,507
Accounts payable and accrued salaries	1,228	444	784
Outstanding cheques, warrants and money orders	1,378	539	839
Deposit and trust accounts			
Gross deposits	579	– 36	615
Less: Securities held in trust and bonds purchased in instalments by employees	162	19	143
	417	*– 55*	*472*
Other	85	75	10
TOTAL OTHER LIABILITIES	*4,909*	*1,297*	*3,612*
Foreign liabilities (See note 3)			
Notes payable to			
International Monetary Fund	990	137	853
Other international organizations	154	70	84
Special drawing rights	370	–	370
Unmatured debt payable in foreign currency	258	– 76	334
TOTAL FOREIGN LIABILITIES	*1,772*	*131*	*1,641*
Unmatured debt outstanding — domestic			
Unmatured debt	29,171	133	29,038
Less: Amount payable in foreign currency	258	– 76	334
Securities issued to Canada Pension Plan Investment Fund	42	8	34
Security Investment Account	42	2	40
TOTAL UNMATURED DEBT OUTSTANDING — DOMESTIC	*28,829*	*199*	*28,630*
TOTAL (See note 1)	46,995	2,657	44,338

NOTES *(These notes deal with significant matters that require specific explanations, but they are not intended to represent the full set of explanatory notes.)*

(1) The statement has been prepared in accordance with the concept that assets are financial claims acquired by the Government of Canada on outside organizations and individuals, and liabilities are its financial obligations to them as a result of events and transactions prior to the accounting date. The unamortized portion of actuarial deficiencies, the treatment of which is an exception to this concept, should be added to the total on the liability side of the statement to arrive at totals for liabilities in keeping with the above definition.

	Balance March 31/74	Net Increase or Decrease (–)	Balance March 31/73
Totals per statement	46,995	2,657	44,338
Unamortized portion of actuarial deficiencies	1,090	307	783
Total liabilities	48,085	2,964	45,121

(2) Treasury bills are issued at a discount but are included in unmatured debt at face value. The unamortized portion of the discount is deducted in arriving at the amounts shown for interest and matured debt at the fiscal year end.

	Balance March 31/74	Net Increase or Decrease (–)	Balance March 31/73
Amounts per statement	1,801	294	1,507
Unamortized portion of discount on Treasury bills	62	26	36
Interest and matured debt	1,863	320	1,543

(3) Foreign assets and liabilities include those financial claims owing to and by the Government of Canada which are payable in foreign currencies and which differ from other transactions in that they are not as readily forecastable or subject to the same degree of control. There are other foreign assets and liabilities, such as the foreign currencies which are included with other cash balances at their Canadian dollar equivalent, and amounts on deposit or in trust which are denominated in foreign currencies and are included with other deposit and trust accounts.

(4) Capital assets of the government, such as land, buildings, works and equipment, which are charged to budgetary expenditure at the time of acquisition or construction, are recorded at a nominal value of $1.

VIEWS OF AUDITOR GENERAL ON RECOMMENDATIONS

The Auditor General of Canada has raised a number of matters in his reports which have a bearing on the Statement of Assets and Liabilities.

First, the Auditor General has commented that certain assets reported in the Public Accounts of Canada do not reflect a policy established by the Minister of Finance in 1920, and still stated as the underlying principle on which the Statement of Assets and Liabilities is prepared as quoted in the Public Accounts. This policy was "that assets to be included in the Statement of Assets and Liabilities should be confined to those which are convertible or which are revenue-producing". The Auditor General has contended that the classification as assets of items that do not meet this policy results in an overstatement of the budgetary surplus, or an understatement of the budgetary deficit.

The recommendations in this report propose a modification or extension of the policy described in the above quotation taken from the Auditor General's report. This report proposes that the Statement of Assets and Liabilities should record all financial claims due to or by parties outside the Government of Canada. It recommends that assets should not be included when they can be discharged only through subsequent budgetary appropriations, and makes only one exception concerning the treatment of claims owing, this being the treatment of the superannuation accounts. Pragmatic solutions are offered to those specific matters which the Auditor General has stated do not meet the policy now quoted in the Public Accounts. In future, the Public Accounts should describe more fully the actual practices followed, and avoid any reference to a policy stated in 1920 which no longer fully covers the practices actually followed. The recommendations in this report propose solutions to the matters raised by the Auditor General, through practices which can be supported as being both practicable and defensible.

The Auditor General has questioned certain specific loans to the National Capital Commission and to the Canadian Broadcasting Corporation on the basis that these can be repaid only out of parliamentary appropriations. Treasury Board has already indicated that these loans will be treated as budgetary grants, and that outstanding loans will be written off in the future. The Auditor General has also contended that the loans to the Saint John Harbour Authority are realizable only through parliamentary appropriations. We have not attempted to determine whether these are in fact recoverable or not. As stated previously, debts between governments are generally settled by re-negotiation, and the accounting should not attempt to anticipate the results of such negotiations.

The Auditor General has contended that the deficit in the exchange fund arising from the fluctuating value of the Canadian dollar should be written off. While this report does not make specific proposals in this regard, proposals are being considered separately which would have this effect.

The Auditor General has contended that a reserve should be provided to recognize that certain loans to provincial governments and Indians provide for future forgiveness of the indebtedness. The proposals in this report for the creation of valuation reserves where there are contingent forgiveness clauses will resolve this issue.

The Auditor General, since he has a statutory responsibility for certifying the Statement of Assets and Liabilities, was specifically asked to comment on the presentation illustrated in Exhibit 8. He has indicated that he favours the changes proposed as compared to the present presentation, but that he would like to see further changes. Some of the changes he proposes are designed to reduce the tendency of the user to think that the statement purports to disclose the financial position of Canada; others concern changes in accounting and reporting practices affecting specific items reported on the Statement.

These changes would result in a fairly radical departure from present accounting and reporting practices and would significantly alter the computation of the annual budgetary surplus or deficit. We find it difficult to support such radical changes without further investigations and discussions.

In view of the fact that the Auditor General favours the changes proposed by us, we believe that they could be acted upon as a first step in improving the accounts of Canada since they are not inconsistent with the more radical changes he prefers. Once the views of the accounting profession and others in Canada who use the Statement of Assets and Liabilities are obtained, after they have had the opportunity of considering this report and the Auditor General's views, further action could be taken.

Chapter 5 -

STATEMENT OF EXPENDITURE AND REVENUE

The present Statement of Expenditure and Revenue of the Government of Canada, which is called for in the Financial Administration Act, lists budgetary revenues by standard headings within the two main categories of tax and non-tax revenue, and lists budgetary expenditures by departments, the net difference being described as "budgetary surplus or deficit".

The Statement of Expenditure and Revenue is supported by various tabulations which provide further details by types of revenue, and further details on expenditures in terms of various appropriations. Later chapters of this report are concerned with the adequacy of these detailed presentations; this chapter is concerned only with the adequacy of the summary presentation.

Two matters are the subject of this chapter: first, the question of whether revenues and expenditures should be presented on the Statement on a gross or net basis; second, the question of the treatment of transactions among parties making up the Government of Canada.

The subject of granting appropriation authority on a net basis is examined in greater depth in later chapters of the report. Proposals are put forward which envisage continued use of net voting in situations involving cost recovery between appropriations and thus there will continue to be authorities granted on a net basis. Proposals also envisage treating fund authorities as budgetary and thus requiring amounts advanced and recovered during the year to be treated as budgetary expenditures and revenues respectively. Continuing these practices will result in net appropriations which are now considered in terms of their effect on the Statement of Expenditure and Revenue.

The details included in the Estimates for both net appropriations and fund appropriations show both gross and net expenditures. The summaries in the Estimates include both amounts in the case of net appropriations, but not in the case of fund appropriations. The detailed statements in the Public Accounts show both gross and net expenditure, but the summary Statement of Expenditure and Revenue contains only the net amounts for both types of appropriations. The Statement of Expenditure and Revenue should be prepared so as to show both gross and net amounts, the net amounts being presented consistently with the manner in which authority is granted in the Estimates. The suggested form of presentation is illustrated in Exhibit 9, using revenues which are now net voted, but excluding revenues now passing through non-budgetary fund appropriations.

The presentation in arriving at net expenditure discloses the amounts of revenue received from other departments which are credited to appropriations. Revenues received by departments which are not credited to appropriations are shown only on the revenue side as part of non-tax revenue. Interdepartmental and intradepartmental transfers are offset in total to show expenditures and revenues in terms of transactions with third parties only. By presenting the offset in total only, the Statement continues to reflect an accounting for expenditures by the agencies to whom administrative responsibility has been assigned. Revenue from third parties outside of government, which would continue to be credited to revolving funds under our proposals, has to be added to net expenditures and revenues to arrive at the true gross expenditures and revenues of the government in relation to third parties.

This proposal will have one further effect. Under the 30-day rule described in the introduction to this report, accounts payable are set up for accounts coming in course of payment during the fiscal year. Proposals in Chapter 7 recommend that all amounts coming in course of

EXHIBIT 9[1]

THE GOVERNMENT OF CANADA

STATEMENT OF EXPENDITURE AND REVENUE FOR THE FISCAL YEAR ENDED MARCH 31, 1973

(with comparative figures for the preceding fiscal year)

EXPENDITURE	Gross expenditure	Revenue credited to appropriations	Net expenditure	March 31, 1972 Net expenditure
	$	$	$	$
Agriculture	317,116,931	4,259,977	312,856,954	286,095,584
Communications	48,417,872	9,616,648	38,801,224	26,406,302
Consumer & Corporate Affairs	29,153,317		29,153,317	23,945,624
Energy, Mines and Resources	170,093,581	2,596,197	167,497,384	175,580,401
Environment	270,398,399	22,345,631	248,052,768	200,723,618
External Affairs	384,554,830	58,012	384,496,818	314,574,823
Finance	3,780,428,703	3,056,659	3,777,372,044	3,542,080,393
Governor General and Lieutenant-Governors	1,411,380		1,411,380	1,197,180
Indian Affairs and Northern Development	509,813,807	6,812,285	503,001,522	435,706,066
Industry, Trade and Commerce	405,184,413		405,184,413	362,572,589
Justice	33,426,319		33,426,319	28,718,595
Labour	27,978,474	73,990	27,904,484	25,407,954
Manpower and Immigration	778,736,604		778,736,604	792,916,827
National Defence	2,140,878,711	159,290,941	1,981,587,770	1,895,174,857
National Health and Welfare	2,934,807,418	25,646,475	2,909,160,943	2,706,075,107
National Revenue	235,056,322	14,795,018	220,261,304	185,245,489
Parliament	32,547,579		32,547,579	32,596,913
Post Office	551,178,462	87,452,685	463,725,777	413,334,381
Privy Council	35,031,278		35,031,278	13,117,333
Public Works	383,581,717	15,613,454	367,968,263	338,054,322
Regional Economic Expansion	358,431,336	33,233	358,398,103	346,393,152
Science and Technology	4,246,549		4,246,549	2,413,328
Secretary of State	962,938,402	7,711,982	955,226,420	862,776,247
Solicitor General	363,943,209	59,477,168	304,466,041	260,062,194
Supply and Services	102,807,224	15,443,989	87,363,235	75,624,230
Transport	662,318,912	79,466,112	582,852,800	502,085,963
Treasury Board	530,370,337	26,467,150	503,903,187	438,754,371
Urban Affairs	163,263,775	1,900,000	161,363,775	129,944,587
Veterans Affairs	481,307,721	36,571,371	444,736,350	423,286,721
Total expenditure	16,699,423,582	578,688,977[2]	16,120,734,605	14,840,865,151
Less Interdepartmental and intradepartmental transfers				
– Credited to Appropriations	378,688,977[3]	378,688,977[3]		
– Credited to Consolidated Revenue Fund	110,000,000[3]	–	110,000,000[3]	
	16,210,734,605	200,000,000	16,010,734,605	14,840,865,151
Budgetary surplus (deficit)[1]			480,868,870	(614,307,381)
			16,491,603,475	14,226,557,770

REVENUE	Gross revenue	Revenue credited to appropriations	Net revenue	March 31, 1972 Net revenue
	$	$	$	$
Tax revenue –				
Income tax –				
Personal	7,172,808,009		7,172,808,009	5,581,982,675
Corporation	2,653,512,860		2,653,512,860	2,183,132,185
On dividends, interest, etc going abroad	291,751,934		291,751,934	287,726,724
Social development tax	15,600,000		15,600,000	408,400,000
Excise taxes				
Sales	2,288,727,371		2,288,727,371	1,984,706,695
Other	400,448,386		400,448,386	388,410,660
Customs import duties	1,181,837,198		1,181,837,198	988,598,886
Excise duties	637,967,354		637,967,354	606,551,387
Estate tax	60,946,059		60,946,059	132,015,951
Miscellaneous	427,361		427,361	392,358
	14,704,026,532		14,704,026,532	12,561,917,521
Non-tax revenue –				
Return on investments			1,264,540,477	1,133,231,110
Post Office – net postal revenue			470,137,417	403,791,138
Refunds of previous years' expenditure			47,639,179	21,481,801
Services and service fees			19,101,960	17,863,304
Proceeds from sales			18,082,072	15,677,551
Privileges, licences and permits			28,103,365	28,326,786
Bullion and coinage			23,746,359	23,549,984
Miscellaneous			26,226,114	20,718,575
	2,097,576,943	200,000,000[3]	1,897,576,943	1,664,640,249
Total expenditure	16,801 603 475	200,000,000[3]	16,601,603,475	14,226,557,770
Less Interdepartmental and intradepartmental transfers credited to Consolidated Revenue Fund	110 000 000[3]		110,000,000[3]	
	16,691,603,475	200,000,000[3]	16,491,603,475	14,226,557,770
			16,491,603,475	14,226,557,770

(1) This exhibit was compiled to illustrate presentation format only.

(2) Revenue credited to appropriations and gross expenditure do not include revenue and expenditure passing through the present non-budgetary fund appropriations, except to the extent that net losses were recouped by means of a budgetary appropriation, or net surpluses were transferred to budgetary revenue

(3) The specific figures do not bear any relationship to actual amounts that may have been involved.

payment during a fiscal year should be charged to appropriations even if this will exceed the appropriation limits. Those accounts payable, which result from inter and intradepartmental transactions, will include some that are not owing to organizations or individuals outside the Government of Canada. To eliminate these transactions, offsetting revenues will have to be recorded in the accounts of the debtor departments. While not in keeping with the normal accounting policy for revenues, this may be regarded as an internal accounting adjustment, similar to a journal entry, since it does not involve revenue from third parties.

The Auditor General has drawn attention to the subject of interdepartmental settlements in previous reports. The proposal to offset these entries on the Statement of Expenditure and Revenue will create a need to identify such transactions, and to ensure that the entries in the books of both debtor and creditor departments are in agreement. Appropriate coding or other techniques will be required for this purpose.

This is not to say, of course, that the accounts presented for individual appropriations should eliminate these transactions. Offsetting should occur on the Statement of Expenditure and Revenue to enable the detailed appropriation accounts of departments to be traced through to the summary Statement.

Recommendation 16 - *The Statement of Expenditure and Revenue should be prepared in a manner which shows expenditures and revenues on both a gross and net basis so that the net amounts are stated consistently with the manner in which amounts are presented in the Estimates. These and other interdepartmental transactions and transactions between appropriations of a department should be deducted to arrive at revenues and expenditures involving third parties.*

The Auditor General has pointed out in his reports that a number of appropriations contain authority to spend revenue, and the accounting procedure is to credit the revenue directly to the appropriation and to report only the net expenditure. In addition, certain revenues go through special accounts and are excluded from the Statement entirely, thereby altering the budgetary surplus or deficit.

The recommendations in this report propose that the Statement of Expenditure and Revenue to be certified by the Auditor General should be prepared to show expenditures and revenues on a gross and net basis by areas of administrative responsibility. The recommendations also propose that all revenue and expenditure transactions, other than those affecting financial claims, with organizations and individuals outside the Government of Canada, as defined, be included on the Statement of Expenditure and Revenue. Certain amounts now accounted for separately in special accounts such as the Unemployment Insurance Account will continue to be reported separately from the Statement, but this is appropriate since these amounts are, in effect, held in trust for third parties.

Implementation of the above recommendation should resolve the matters noted by the Auditor General.

Chapter 6 -

ACCOUNTING FOR REVENUE

Revenue is classified in the accounts of Canada under two main headings - tax revenue and non-tax revenue. Tax revenue, which is by far the greater, consists of the proceeds from income tax, sales tax and other excise taxes, excise duties, customs duties, estate tax and certain other miscellaneous taxes. Non-tax revenue includes returns on investments, postal revenue, and a variety of receipts from fees, sales, charges and recoveries. In addition to these two classes of revenue, receipts are credited to non-budgetary accounts as a result of the payment of financial claims owing to the Government of Canada, credits to social security and superannuation accounts treated as non-budgetary, and such other accounts as are reported on the Statement of Assets and Liabilities.

This chapter is concerned with three matters: first, the difficulties in determining income tax revenue; second, the problems encountered in recording the receipts of revenue; and finally, the basis on which revenues are reported in the accounts of Canada.

DETERMINATION OF INCOME TAX REVENUE

The liability to pay income tax is assessed on the basis of income earned by a taxpayer during a particular year. This is the calendar year for most individuals, but in the case of self-employed persons and corporations and for some others, it is any fiscal period ending during the calendar year.

Tax collections however do not await assessments; rather they generally result from payments made by installments, or on filing, in advance of actual determination of the liabilities upon assessment. In the case of employees, deductions are made from their salaries and wages, and the sums so deducted are forwarded by employers to National Revenue (Taxation). These deductions are estimates of taxes payable.

Similarly, in the case of the self-employed and corporations, taxes are paid in installments. These installments are also calculated on the basis of estimates of the amounts of tax due.

In addition to collecting federal income taxes, National Revenue (Taxation) also collects Canada Pension Plan and Unemployment Insurance contributions, and income taxes for those provincial governments which have entered into federal-provincial agreements. Amounts received by National Revenue (Taxation) may be for all of these purposes, and as a result, problems arise in the distribution of these amounts among the various accounts to which they pertain.

Under present practices, refunds are first deducted from collections. From the net amount, amounts are distributed to the Canada Pension Plan and to the Unemployment Insurance Account based on estimates of the likely contributions. A further adjustment is made by allocating amounts to the Provincial Tax Collection Agreements Account to allow for amounts owing to the provincial governments. Separate percentages, which change from time to time, are used to ascertain the provincial shares of personal and corporation income taxes. A final deduction is for amounts allocated to the Old Age Security Account. These amounts are estimates of what would be payable to the Account if the former Old Age Security Act were still in force. The balance after all these allocations is the amount of income tax credited to budgetary revenue.

When the taxpayer's liability is subsequently assessed, usually after the end of the taxation year concerned, the amounts credited to these various accounts are adjusted. This adjustment for any given taxation year is based on assessments made in the following twelve months. The Government of Canada is committed to settling with the provinces, the Canada Pension Plan and the Unemployment Insurance Account on the basis of assessments and not collections. The final amount of federal income tax for a given taxation year is thus the residual amount after all settlements have been made with these other accounts.

In summary, budgetary income tax revenue may be defined in two ways:

1. Collection of federal and provincial income tax

   plus - collections of Canada Pension Plan and Unemployment Insurance contributions

   plus - all penalties collected

   less - payments of assessed amounts of provincial income taxes, Canada Pension Plan and Unemployment Insurance contributions

   less - allocations to the Old Age Security Fund.

2. Sums assessed as federal income taxes

   less - sums assessed but not collected for federal and provincial income taxes, Canada Pension Plan and Unemployment Insurance contributions

   less - allocations to the Old Age Security Fund.

Federal income tax revenue therefore differs from what it would be, in the absence of the joint collection arrangements, by the amount of provincial income taxes, Canada Pension Plan and Unemployment Insurance contributions assessed but not collected. It should be noted, however, that as an offset National Revenue (Taxation) also levies and collects interest and other penalties which it retains in full and credits to non-tax revenue.

Where the Government of Canada has agreed to administer provincial programs for tax credits, arrangements have been made to obtain information on tax credits assessed on a monthly basis and these amounts are charged each month to provincial accounts. This practice contrasts to the practice of making the adjustment to the Provincial Tax Collection Agreements Account based on other assessments made in the twelve-month period following the end of the taxation year.

Determining income tax revenues in this manner is the result of the federal system of government where federal income taxes, provincial income taxes and social security contributions are combined. It requires collections to be allocated on an estimated basis, and leads to adjusting entries when assessed amounts are known. While ultimately the agreed distribution of total collections is determined, in any particular year, the figures for budgetary revenues and non-budgetary receipts will differ from those that would have resulted if the liabilities of individual taxpayers could have been assessed on a current basis.

Since this is not likely to be feasible in the case of income taxes, any possibilities for more accurate allocation of collections are likely to be found in the area of various social security contributions. Efforts should be made to ensure that, when remittances are made, the amounts remitted for the Canada Pension Plan and Unemployment Insurance are separately reported. An analysis of such information would then provide a check on the accuracy of present estimates, and as a result lead to a more accurate computation of income tax revenue.

Recommendation 17 - *The possibility should be fully explored of identifying more accurately contributions to the Canada Pension Plan and Unemployment Insurance accounts, and of analysing them with a view to improving on present estimates of amounts credited to these accounts from current collections.*

THE TIMING OF RECEIPTS OF REVENUE

All money that has been received by collectors of public money -for example, the various branches of departments - is included in the receipts of the fiscal year, even though not deposited in the Consolidated Revenue Fund. This practice prevents variations in receipts because of the time required to transfer and deposit money to the credit of the Consolidated Revenue Fund. While these sums in transit or in the hands of collectors are recorded as a separate asset on the Statement of Assets and Liabilities, the transactions pertaining thereto are included as budgetary revenue or as non-budgetary receipts of the fiscal year in the same manner as would have been true if these amounts had been deposited in the Consolidated Revenue Fund.

Cash receipts are normally cut-off at the close of business on March 31st, the fiscal year-end, but certain exceptions are permitted:

- refunds of old year expenditures will be accepted if reported up to May 31st;

- revolving fund and working capital advance accounts are permitted to remain open and receipts to be credited thereto where these are applicable to the old year. Transfers of profits to revenue are accepted up to June 20th; and

- interdepartmental settlements by cheques are credited to the closing fiscal year if cheques are dated in March or if a cheque dated in April is to be charged to the appropriations of the payer in the previous fiscal year.

There are therefore always some receipts after March 31st that are credited to the fiscal year ending on that date. These amounts, however, are reported separately on the Government of Canada's Statement of Assets and Liabilities.

One problem in the application of the above procedures is that departments paying an interdepartmental charge in April from an old year appropriation do not always inform the receiving department of this fact. As a result, interdepartmental revenue can be credited to the wrong fiscal year. This problem should be resolved by proposals approved by Treasury Board to settle interdepartmental transactions by a document other than a cheque.

A special problem arises when there is a holiday on March 31st; Section 25(1) of the Interpretation Act then applies so that the fiscal year ends on the "day next following that is not a holiday". This legal provision does not mean that all receipts on the next business day following the holiday are to be included in the fiscal year just ending; receipts arising from business transacted on that day are for the account of the new fiscal year. The problem is therefore to distinguish those receipts on the business day following the holiday that, but for the holiday, would have been received in the fiscal year just ending and those arising from business transacted on that day and therefore attributable to the new fiscal year.

These exceptions to the normally cash basis of accounting for receipts appear to be appropriate, and no recommendations for changes are submitted.

THE CASH BASIS OF ACCOUNTING FOR REVENUES

Revenue, both tax and non-tax, is now generally recorded in terms of the amounts of cash received. These receipts are not adjusted for accruals. This basis of reporting revenue is used not only by the Government of Canada but by most governments including those of Australia, the United Kingdom and the United States. It is therefore, in fact, a "generally accepted accounting practice" of national governments. The question is why such governments have adopted the cash basis instead of the accrual basis of reporting revenue.

One of the main reasons why accrual accounting for revenue was developed - namely to assist in the measuring of the income of a business - does not apply in government. Business revenue is recorded when the goods or services are delivered to customers. This delivery is an act that originates within the business; it can therefore be identified, measured and valued. In contrast, government revenue consists mainly of taxes and the amounts of tax payable by any taxpayer are not directly related to goods and services delivered to him by the government. Taxes are, in fact, payments for which no direct "quid pro quo" are rendered by the government; in economic terms, they are transfer payments. The liability for their payment accrues outside the government, and as a result, governments do not have records to relate tax revenues to the time periods when the tax payments actually accrued.

As stated earlier, the process of tax assessment covers a considerable period of time. In addition, tax assessments can be contested. Legally, any person can challenge the assessments made by a tax collector; similarly, the tax collector can consider the methods of tax avoidance practised by a taxpayer to be unacceptable. It can take years to discover and settle in the courts some systems of tax avoidance or evasion.

Another reason for governments not accounting for tax revenues on an accrual basis is that the allocation of even determinable amounts of revenue to time periods is difficult. For example, the introduction of a system of accelerated depreciation delays the receipt of tax revenue from taxpayers. The question then arises whether the revenue should be accrued when taxpayers earn income or when they are due to pay tax. The difference in time may be years, and in addition, their receipt may be hypothetical because of subsequent events.

As a final reason, the raising of tax revenue is centralized in most governments, and departments do not rely on certain allocated sources of revenue. Departmental management is therefore not concerned with the raising of most of revenue upon which they depend. Available funds are allocated to those programs designed to achieve desirable objectives without regard to revenue earning capacity. There is therefore no direct connection between expenditures of a department and government revenue. Departmental management requires only certainty that its authorized cash requirements will be met, and this certainty is best provided by relying on revenue received in cash.

Most of the above arguments apply only to tax revenues. In the case of non-tax revenues, particularly those revenues which are available for expenditure under net or fund appropriations, the arguments are quite different. Accordingly, in Chapter 8 accrual accounting is recommended for fund appropriations, although as a supplement to, not in lieu of normal governmental cash accounting practices. Similarly, good management of non-tax revenue requires that revenues be claimed as soon as they are recognized and that they be kept under good accounting control until collected. This is best achieved by practising accrual accounting. Nevertheless, as in the case of fund appropriations, this can be done on a supplemental basis, and through use of contra or memorandum accounts the same benefits can be realized. Thus, there seems to be little benefit in departing from the practices followed in respect of

tax revenues, and non-tax revenues should be reported in the financial statements of Canada on the same cash basis. Accounts receivable records should be kept, but on a supplemental basis which can be reported in the Public Accounts, but without any potentially misleading impact on the budgetary accounts by having the two types of revenue reported differently.

Recommendation 18 - *Tax and non-tax revenue should continue to be reported on a cash basis on the Statement of Expenditure and Revenue.*

Chapter 7 -

ACCOUNTING FOR APPROPRIATIONS OTHER THAN FUND APPROPRIATIONS

It is fundamental to the parliamentary system of government that only Parliament can grant authority for the expenditure of public funds. The method of granting such authority is through appropriations which specify the purposes for which the authority can be used. These appropriations vary in the form in which the authority is granted, and the practices that they permit:

- authority may be obtained through Appropriation Acts approved as a result of items submitted in the Estimates and subsequently reported in the Public Accounts, but the Financial Administration Act and other legislation also grant appropriation authority, details of which are not always included in the Estimates and Public Accounts;

- the purposes of an appropriation may be very explicitly stated or may be very general;

- authority may be granted on a gross, or on a net basis;

- authority may be granted on an annual basis with authority lapsing at the end of the relevant fiscal year, or authority may be granted on a multi-year or continuing basis;

- authority may be granted in terms of services coming in course of payment during the fiscal year or authority may be granted independent of the time of payments; and

- constraints may or may not be imposed in terms of commitments that may be entered into in future years.

All these matters are considered in this chapter.

All types of appropriations require information to be submitted to Parliament to secure its approval. In addition, reports indicating actions taken are generally submitted after the event as this is the essence of accountability. This reporting is necessarily in terms of the legal authority granted, but in addition it is normal to provide an accounting in relation to the information submitted in securing such authority.

This chapter does not cover revolving fund or working capital advance authorities. This special type of net and non-lapsing appropriation authority is discussed in the following chapter because of the many differences in treatment.

REPORTING OF APPROPRIATIONS IN ESTIMATES AND PUBLIC ACCOUNTS

In the Estimates, the votes of the department and agencies for which a Minister is responsible or reports to Parliament are grouped together to provide a total ministry presentation. At the beginning of the presentation for each ministry a General Summary provides details of votes under headings which describe individual departments and agencies, and sub-headings which describe programs. These votes include both budgetary expenditures and non-budgetary loans, investments and advances. On the General Summary the nature of the vote is identified by (S) if statutory and no parliamentary action is required, and by numbers if the amounts are to be voted, the number being preceded by the letter (L) if the vote is a non-budgetary loan, investment or advance.

In keeping with the concept of parliamentary appropriation on a program basis, the bulk of the Estimates book is made up of a number of standard sections for each departmental program. By far the most important section is the one that provides the complete wording of the

votes and the proposed amounts which will appear in the Appropriation Acts. Other tables show supporting details by the activities making up the program and by the twelve standard objects of expenditure used to indicate the resources acquired to carry out the program. In addition, a narrative statement of objectives and sub-objectives for each program, and a program description which explains the work carried on under each activity of the program is submitted.

In Chapter 3 where the presentation of summary information in the Estimates was discussed, it was recommended that on summaries, in the case of both budgetary and non-budgetary appropriations, a distinction be drawn between amounts to be voted and estimates of expenditures. This will remedy one of the major deficiencies of the Estimates presentation.

All tables other than the General Summary and the Votes and Statutory Items table, where an estimates to estimates comparison is made, provide a comparison between estimates, forecast expenditures for the current year and actual expenditures for the year prior to that. Exhibit 10 illustrates how the General Summary and the Votes and Statutory Items table should be revised to draw better comparisons of amounts to be voted and of expenditures. These would then build up to summary Main Estimates Table 2 illustrated in Exhibit 5. Other supporting tables would not need any significant revision except to change the term "estimates" to "estimates of expenditure" consistent with the definitions in Chapter 3.

There are a number of statutory or multi-year authorities which provide authority to make non-budgetary loans, investments or advances, but these are not now displayed where the authority has been voted in a prior year. These, as well as all multi-year budgetary appropriations not now reported, should be displayed in the Estimates in order to indicate the total estimates for the fiscal year in relation to annual, multi-year and statutory authorizations granted by Parliament. Additionally, there should be supporting tables, like those now used for revolving

EXHIBIT 10

ILLUSTRATION OF PROPOSED ESTIMATES GENERAL SUMMARY

BY DEPARTMENT

Estimates, 197–, 7–

MAIN ESTIMATES

Department | Ministère

General Summary | Sommaire général

Page	Vote No.	Program	Amounts to be Voted 1974-75	Amounts to be Voted 1973-74	Amounts to be Voted Change	Centre Page Fold	Expenditures: Estimates of expenditure 1974-75	Expenditures: Forecast of expenditure 1973-74	Expenditures: Actual expenditure 1972-73	Page	No. du crédit	Programme
		A – DEPARTMENT										A – MINISTÈRE
3-2	(S)	Minister of ________ Salary and Motor Car Allowance	XX	XX	–		XX	XX	XX	3-2	(S)	Ministère ________ Traitement et indemnité d'automobile ....
3-2	1	Operating expenditures	XX,XXX	XX,XXX	X,XXX		XX,XXX	XX,XXX	XX,XXX	3-3	1	Dépenses de fonctionnement .....
3-2	5	Capital expenditures	X,XXX	X,XXX	XXX		X,XXX	X,XXX	X,XXX	3-3	5	Dépenses d'investissement .
3-12	10	Revolving fund	XXX	XXX	X		XXX	XXX	XXX	3-13	10	Fonds renouvelable
		Total Program	XX,XXX	XX,XXX	X,XXX		XX,XXX	XX,XXX				Total au titre du programme . .

A – DEPARTMENT OF

Budgetary	Amounts to be Voted 1974-75	Amounts to be Voted 1973-74	Amounts to be Voted Change	Centre Page Fold	Expenditures: Estimates of expenditure 1974-75	Expenditures: Forecast of expenditure 1973-74	Expenditures: Actual expenditure 1972-73	Budgétaire
Vote 1 – Operating expenditures, the grant listed in the Estimates and contributions and authority to make	XX,XXX	XX,XXX	X,XXX		XX,XXX	XX,XXX	XX,XXX	Crédit 1 – Dépenses de fonctionnement, subvention inscrite au Budget et contributions et autorisation de ....
Vote 5 – Capital expenditures	X,XXX	X,XXX	XXX		X,XXX	X,XXX	X,XXX	Crédit 5 – Dépenses d'investissement ....
Statutory – Minister of ________ Salary and Motor Car	XX	XX	–		XX	XX	XX	Statutaire – Ministre ________ Traitements et indemnité d'automobile ....
Total Program	XX,XXX	XX,XXX	X,XXX		XX,XXX	XX,XXX	XX,XXX	Total au titre du programme ....

fund authorities, for loans, investments and advances authorities since these are normally granted on a net basis with the authority designating only the amount that may be outstanding at any point in time.

The case for reporting non-budgetary expenditures, other than loans, investments and advances, in the Estimates is not strong. To forecast Canada Pension Plan or Unemployment Insurance benefit payments without also forecasting revenues would not be desirable. Foreign exchange transactions are a consequence of events beyond the direct control of the government, thereby making forecasts difficult. Finally debt and miscellaneous transactions, such as accounts payable and cash intransit, are a consequence of or result from other transactions and are thus difficult to forecast. These types of matters, for which there is statutory authority without limits being imposed by Parliament, are not suitable for presentation in the detailed format of the Estimates. If, however, all loans, investments and advances were to be included, the Estimates would provide a more complete display than at present, even though they would not present all disbursements to be made from the Consolidated Revenue Fund.

Turning to the Public Accounts, budgetary appropriations are reported individually in the Public Accounts in both Volumes I and II. Non-budgetary appropriations for loans, investments and advances are not reported in the same detail in the Public Accounts.

Volume I provides several summaries of appropriations, expenditures and unexpended balances, including amounts unexpended which are carried forward. The same volume includes a complete tabulation of budgetary appropriations and expenditures by departments showing appropriation wordings, amounts appropriated, expenditures and unexpended balances for the fiscal year, with comparative figures for the preceding year. This tabulation includes statutory items. In the case of statutory

items the actual amount expended is shown as being the appropriation because, under a statutory authority, the amount spent may be deemed also to be the amount appropriated. This practice, while legally correct, is somewhat misleading in that expenditures are not compared with amounts forecast in the Estimates and as a result the total reported as appropriations does not equal the total represented as estimates in the summary tables of the Estimates. The Public Accounts should include comparisons both with amounts to be voted and with estimates of expenditures, as presented in the Estimates, so that the actual expenditures can be compared with those anticipated when parliamentary authority was requested.

Volume II should provide details for each ministry in a similar form.

Thus, the Public Accounts provide a comprehensive and detailed reporting on all budgetary appropriations included in the Estimates. This permits Parliament to relate actual expenditures to budgetary authorities voted, as well as to estimates of expenditure if, as proposed in Chapter 3, these amounts are to be shown separately in the Estimates book.

No similar detailed listing of appropriations for loans, investments and advances is provided, neither those approved in the current year nor those approved in previous years. Budgetary appropriations are now accounted for in both Volumes I and II of the Public Accounts. Loans, investments and advances should be added to budgetary appropriations reported in detail in the two volumes to provide a more complete accounting of all appropriation authorities by the responsible departments.

Recommendation 19 - *The Estimates book should include estimates of expenditures under all non-budgetary loans, investments and advances appropriations and the Public Accounts should show a comparison of actual expenditures with*

estimates of expenditures forecast for all appropriations included in the Estimates.

STRUCTURE OF APPROPRIATIONS

The votes contained in the Estimates determine the basis on which Parliament appropriates funds. The present vote structure for budgetary appropriations is based on the following principles:

- a minimum of one vote for each legal entity or unit of government operating under an Act of Parliament and responsible directly to a minister;
- separate votes for each major program for which the legal entities or departmental units are responsible; and
- separate votes within each program wherever capital, or grants and contributions, or both, are estimated to be equal to or exceed $5,000,000.

In addition, separate votes are established to provide for the deficits of Crown corporations, and a single contingencies vote of Treasury Board provides for miscellaneous, minor and unforeseen expenditures and for certain increased salary costs arising out of collective bargaining agreements.

While the above description of the vote or appropriation structure may appear to suggest that several characteristics govern the structure, since 1969 the focal point has been the program, or the purpose or objective for which funds are appropriated, supported by activities which identify the means by which program objectives are attained.

Where departments carry out operations to support an objective for which another department has primary responsibility, such departments generally recover their costs. This has been done by permitting a department to credit any recoveries from other departments to its appropriations, or by financing common service organizations through a revolving fund or similar account so that all costs are passed through to benefitting programs. Where a department is funded to support programs of other departments, such costs, where material, are identified with the benefitting programs in a notational manner in the Estimates.

The program/activity basis of the vote structure is primarily designed to inform Parliament and the public in very broad terms of the purposes for which funds are being spent. The program/activity structures of many departments are mirror images of their organizations, i.e. programs reflect large organizations and activities lesser organizations. Estimates are prepared on the basis of organizational requirements which are aggregated to activities and programs based on predominant purposes. Where the program/activity framework differs from the organizational structure, cost allocations are made in an approximate manner based on rough estimates of the purposes for which funds will be used. Some departments and agencies do have operational and project costing systems producing information which could be aggregated for purposes of the Estimates and Public Accounts, but they have chosen to continue to construct the Estimates through allocating organizational costs.

This description of existing practices indicates that the Estimates and the Public Accounts generally display organizational costs or else organizational expenditures allocated in a very approximate manner.

The parliamentary concept of ministerial responsibility for departmental programs is well established, and the present information displays this responsibility in the Estimates and Public Accounts. The program approach enables the responsible minister to explain to Parliament and the public the objectives assigned to his department, and this is obviously a better basis for structuring appropriations than one which identifies organizational responsibilities.

Programs and activities will always be stated at high levels of aggregation so that Parliament and the public will not be inundated with excessively detailed information. Precise costing may never be feasible, but a number of techniques and methods can be employed to a greater or lesser extent by departments for purposes of allocating costs. These cost allocation techniques should be selected so as to produce reasonably accurate costs without resort to arbitrary allocation techniques. Once selected, it is of vital importance that accountability reports be prepared on the same basis as that used to support appropriation requests.

Recommendation 20 - *Appropriations should be structured on a program basis which best explains the purposes for which funds are to be expended, and the amounts attributed to each program should be defined precisely enough to ensure that expenditures can be accounted for in the Public Accounts in a manner consistent with that used in preparing the Estimates.*

NET VOTING AND COST RECOVERY

Parliament normally appropriates funds for expenditure on a gross basis; any revenue derived from the provision of services is ordinarily not available to departmental management to extend or improve the services except by specific action of Parliament. A direct relationship

between expenditures for a service and particular revenues can seldom be established. There are, however, a few instances where expenditures and revenues can be linked, and gradually over the years the practice of permitting the netting of certain revenues against expenditures has been introduced. By the early 1960's there were 31 such net appropriations approved by Parliament.

In 1962, the Report of the Royal Commission on Government Organization (Glassco) recommended the extension of the practice of net voting. It was the opinion of the Commissioners at the time that:

> "control would not be lost by either Parliament or the Executive if all vote and allotment controls were to be based on net, rather than the gross cost of services, provided the revenue is directly derived from the provision of the service optional to the user".

The Glassco Commission in recommending in favour of the net voting practice did so on the basis that parliamentary control would not suffer provided that revenue is directly derived from the provision of a service optional to the user. The basis for this view was that consumer demand would control the expansion (or contraction) of such services and Parliament needed to be concerned only where the charge was not of an optional nature.

The purposes for this recommendation were primarily to:

- provide departmental management with incentive to increase non-tax revenue; and

- encourage managers to charge a fair price for services for which the public was willing to pay.

The facts demonstrate, however, that there is generally little relationship between the revenue credited to votes and corresponding expenditures. Certain revenues, for example fines and penalties, represent charges which are not of an optional nature. In other cases, there is no real option for a user to refrain from using a service which only the government provides. Hence the conditions recognized by the Glassco Commission rarely apply. The effect is not to give management the incentive that the Glassco Commission envisaged, but rather, if revenues are estimated conservatively, to create a fund for financing unanticipated requirements.

The facts indicate that:

- management has been little concerned with obtaining financial information that would permit it to know and control the relationship between revenue and expenditure;

- the introduction of net voting has not had a major impact on rates charged for services; and

- increased charges for services appear in practice not to be within managerial discretion.

Most departments operating on a net voting basis do not apply the practice internally. Gross budgets are approved for individual managers, and revenues are controlled centrally for allocation as and when required. This means that responsibility centre managers are entering into commitments as if revenues had already been realized. Because revenues are estimated conservatively, this procedure does not generally lead to over-spending of appropriations, but it is obviously questionable whether, as practised, net voting provides any real management incentive.

Most appropriations are now on a gross basis because most government programs are financed out of general tax revenues. Gross appropriations ensure that each service competes equitably for available resources. Net voting is an attempt to introduce a quasi-commercial practice into the resource allocation process. It assumes that a program has prior call on revenues derived therefrom and the service grows or contracts in relation to its revenue-earning capacity. Because departmental accounting in most cases does not result in revenues and related expenditures being compared, it is not possible to determine whether programs do in fact contract where revenues fail to materialize. Further, since there is little consistency in the application of net voting and similar types of revenue are often treated differently even within a single department, net voting as presently practised may be distorting, rather than improving, resource allocation decisions.

Although Treasury Board places all revenues in excess of 125 percent of those estimated under separate allotment control, the Auditor General has proposed that, where authority is provided for the spending of revenue, three figures - estimated gross expenditure, estimated revenue and net amount appropriated - should appear in the appropriation itself and the amount of revenue used to supplement the net amount appropriated should be limited to the estimated revenue shown in the appropriation".

Consideration was given to retaining net voting in the form proposed by the Auditor General in order to facilitate resource allocation since it would make expenditures contingent upon generation of revenue. Departments, however, are not likely to favour an arrangement whereby they are penalized if revenues fall short, but where they derive no benefits if they exceed the amounts forecast.

There is one form of net voting that should be continued. In the previous section of this chapter, it was indicated that net voting practices have permitted more accurate identification of program costs through the device of charging a benefitting program for services provided to it and of crediting recoveries to the servicing program. This practice

does not alter the total expenditure authority granted by Parliament, but only its distribution among programs. Generally, this type of net voting relating to intragovernmental services appears to be advantageous since it results in a more accurate display of program costs. However, such recoveries should be restricted to actual incremental expenditures, and there should be no recovery of fixed departmental costs or of imputed costs not paid out of the current appropriation since such practices undermine Parliament's intention of specifying the purposes for which funds can be used in appropriations. Under this restricted interpretation, there should be no need for either Parliament or Treasury Board to restrict the amounts recovered to those shown in the Estimates.

Recovery of incremental expenditures will be appropriate for those programs where the services provided are incidental to the main purpose of the program. Where the main purpose of a program is to provide common services to other departments and to other programs, recovery of only incremental expenditures is obviously not satisfactory. In these circumstances, a fund authority should be obtained since this permits full cost recovery. The use of funds for this purpose is discussed in the next chapter of this report.

This limitation of net voting may seem to reduce the incentive of management to maximize non-tax revenue, but this would not be the case if departments generating additional revenues receive proper consideration when they request additional spending authority. Where there is, in fact, a close relationship between expenditures and revenues, departments should have little difficulty in justifying their requests for expenditure authority. To believe otherwise is to cast doubt upon the efficacy of the whole resource allocation process.

Recommendation 21 - *Net voting of revenues derived from outside the Government of Canada should be discontinued.*

Recommendation 22 - *Amounts recovered from other appropriations should continue to be net voted but such recoveries should be restricted to incremental expenditures.*

ANNUAL LAPSING OF AUTHORITY

This part of the report is concerned with limitations on appropriation authorities in respect of time. In the Financial Administration Act, Section 20 states that the Estimates "shall be for the services coming in course of payment during the fiscal year". The intent of annually lapsing appropriations is that Parliament should once a year have an opportunity to review all programs, and by approving the Estimates, to endorse the continuation of each and every program. This annual opportunity for redress of grievances is fundamental to our system of parliamentary government.

Financial authorities, however, must also be framed in a way to take account of the interests of third parties with whom contractual agreements have been made or to whom undertakings have been given, especially where those to whom payment is made may be dependent upon regular and recurring receipts of funds from the government. In such a situation, what is required is reasonable certainty that the payments in question will be made on their due dates without delay until an annual appropriation bill is passed. For example, interest payments on the public debt, pensions, government annuities, family allowances, unemployment insurance payments and payments to provinces are all disbursed under authorities that do not lapse at the end of a fiscal year. Statutory authorities in these circumstances appear to be desirable since any annual limit on such expenditures could lead to the interruption of such payments.

In addition to statutory authorities, Parliament has authorized several types of appropriations that provide authorities, which do not lapse at the end of the fiscal year.

Certain appropriations authorize expenditures "in current and subsequent years". The case for providing authorities to disburse stated amounts without any limitation of time does not appear to be strong. Such authorities lessen the control of Parliament and reduce the ability of central agencies to control expenditures annually in a manner which best corresponds to the nation's changing fiscal requirements. The disadvantages of this practice become clearer when it is recognized that sums authorized are often in excess of annual expenditures, thus

adding to amounts previously carried forward and providing a cushion against budgetary constraints in future years.

The practice of providing specific amounts that can be disbursed over a stated period of time longer than one year, is not in common use in Canada. A case can be made for planning over a period of longer than one year but to use this device as a basis for requesting authority is debateable. It seems preferable to have annual appropriations which can be treated as modules in a developing program and which can be suitably adjusted in content and size within multi-year plans.

A different type of non-lapsing appropriation consists of appropriations which authorize funds to be credited to special accounts in the Consolidated Revenue Fund. In Chapter 4 it was concluded that any balances in these accounts cannot properly be regarded as liabilities of the Government of Canada. They should not therefore be treated as budgetary expenditures until the funds are in fact expended. Some examples of this type of appropriation include: the international assistance account of the Canadian International Development Agency, the replacement of material and surplus assets accounts of National Defence, the National Library and National Museums purchase accounts of the Secretary of State, the railways crossing fund of the Canadian Transport Commission, and the national capital fund of the National Capital Commission. Regular credits are made to most of these accounts either by means of annual appropriations shown as budgetary expenditures, or by non-lapsing appropriations of specific revenues. There seems to be little need to set aside funds for purposes which can be easily estimated on an annual basis and the practice should be discontinued, since it is not consistent with the concept of annual parliamentary control. Accordingly, in chapter 4 of this report, it was recommended that this practice be discontinued.

There is one other apparent type of non-lapsing appropriation. This involves the practice of introducing new programs through final Supplementary Estimates. This is done where it is too late to include the program in the Main Estimates of the following year, or where to wait for the Supplementary Estimates may unduly delay the introduction

of a program. In these circumstances, an appropriation authority may have to be granted which authorizes expenditures in the following fiscal year. Where this type of appropriation is used, the total authority should be limited to the current and subsequent fiscal year thus retaining the basic principle of annually lapsing appropriations.

The analysis to this point has not examined whether a different case can be made for non-lapsing authorities in respect of non-budgetary loans, investments and advances. The answer depends on the purposes for which non-budgetary advances are being made. Some are incidental to a program's objective and are made only to facilitate it. These are normally granted on a non-lapsing basis with limits being imposed on the amounts that may be outstanding at any point in time since the timing of the advance is not particularly significant. Others are made to achieve a specific purpose within a limited period of time, and these should accordingly lapse.

The Auditor General has commented that a number of practices authorized by Parliament are contrary to the spirit of Section 20 of the Financial Administration Act, which provides that spending authority granted by Parliament should lapse at the end of the fiscal year in which it is given. The above analysis generally concurs, except in those cases where a statutory authority has been granted by Parliament wherein the purposes of transactions are clearly specified and the amounts of individual transactions are limited, or where the expenditure is recoverable and a limit on amounts that may be outstanding at any point in time is a more appropriate means of control.

One argument that is often advanced against annual appropriations is that they encourage departments to use up expiring authority at the year-end in order to avoid lapses. There is some merit to this argument because a department that appropriately controls its expenditures during the year will ensure that funds are available to discharge all commitments

into which it has entered. Therefore it will only be towards the end of the year when that department can safely spend funds which have been previously set aside for commitments. When commitments do not materialize, a department often has little time to select alternative uses for such funds and thus its choices may be subject to question. This difficulty is better resolved by providing commitment authority in excess of the amount of funds voted, and should not be cause to depart from the practice of annually lapsing appropriations. Should all commitments materialize this would be a justifiable instance of over-expenditure which would be offset by savings in the following year under the procedure proposed in the next section of this report.

> Recommendation 23 - *Annually lapsing authority should be granted wherever possible and time limits should be removed only where the purposes and the criteria for the determination of individual transactions are clearly specified in appropriate statutes, or where in the case of loans, investments and advances a limit is imposed on the amounts that may be outstanding at any point in time.*

MODIFIED CASH BASIS OF GRANTING AUTHORITY AND ACCOUNTING FOR APPROPRIATIONS

Traditionally, Parliament has granted authority on a cash basis and the accounting for appropriations had been on the same basis. However, there have been a number of exceptions to this general rule which are now examined.

30-day rule

Parliament has provided that accounts coming in course of payment during the fiscal year may be charged against the appropriation authority even though cash is not disbursed, provided it is in fact

disbursed within 30 days of the fiscal year-end. Such transactions are treated in the same way in the Statement of Expenditure and Revenue and in the accounting for appropriations as if the cash disbursements actually took place during the fiscal year. On the Statement of Assets and Liabilities, however, the amounts paid in this period are recognized as accounts payable at the fiscal year-end, since year-end cash balances remain unchanged.

This modification to pure cash accounting is necessary if the appropriations are to cover all accounts coming in course of payment during the fiscal year. It is normal for suppliers to bill periodically, and it takes time to exercise all the controls that are necessary in order to ensure that an invoice covers services actually rendered before passing the account for payment.

However, the practice does have some shortcomings:

- first, it delays the closing of the year's accounts for at least 30 days, because while a liability may be recognized earlier, the account cannot be recorded until a cheque is issued; and

- second, it fails to recognize those transactions which, while coming in course of payment during the fiscal year, are not in fact paid in the 30-day period, because the appropriation has been fully expended or because the account was not able to be processed for payment within the 30-day period.

The Auditor-General of Canada states in his 1973 Report "that the present procedures whereby appropriations are not reported as over-expended, through the technique of withholding payment by the Crown until a further appropriation becomes available, are misleading and

should be reviewed". We have concluded that, while present practices are clearly authorized by law, the Financial Administration Act should be amended to require that all accounts coming in course of payment must be recorded as expenditures of that fiscal year even if this exceeds the amount of the appropriation.

Implementation of such a recommendation poses two problems. First the Financial Administration Act would have to be amended to permit expenditures to be recorded even though they exceed limits on amounts that may be charged to appropriations under authority granted in Appropriation Acts. Second, some means must be introduced whereby Parliament provides the necessary authority to appropriate funds from the Consolidated Revenue Fund to discharge any accounts payable which are set up as expenditures when the appropriation authority is exceeded. The first can be attained by amending Section 30 of the Financial Administration Act to require all amounts coming in course of payment during the fiscal year to be set up as accounts payable and to be recorded as expenditures of the year then ending. Several alternatives are available to provide the necessary authority for charges to appropriations where the appropriation authority is exceeded.

First the practice of several other countries could be adopted - namely, to cover the excesses by passing appropriations after the end of the fiscal year. The Supply rules of the House of Commons now provide for such Estimates. However, this would add to the workload of the House; it would result in Parliament being asked to grant authority to settle liabilities to third parties, which would rarely be refused; and its main purpose would be to reprimand offending departments.

Another alternative is the practice adopted by some other governments - namely to permit Treasury Board to use its Contingencies Vote to supplement other appropriations. This would avoid an extra set of Estimates for miscellaneous minor amounts. Where the Contingencies Vote is not adequate, specific parliamentary approval would still be required through Estimates approved after the year-end.

The preferred alternative is however slightly different. It follows from the previous proposal to amend the Financial Administration Act to distinguish between expenditures and charges to appropriation authorities. If the Act is amended to require all services coming in course of payment during the year to be recorded as expenditures of that year, the accounts of Canada will record the fact where expenditures exceed appropriation limits.

This does not, however, automatically require that charges to appropriation authorities need to be permitted in excess of the appropriation limits approved by the Governor in Council under Section 21 of the Financial Administration Act. It is our view that payments made subsequent to the year-end, which are to settle accounts payable applicable to the prior year, should be charged to the prior year's appropriation authority provided they do not exceed the limits imposed by Parliament, and should be charged to the subsequent year's appropriation authority, once the approved limit has been reached. This is in effect the present practice except that a 30-day limit is imposed on such payments. Where payments are charged to the subsequent year's authority, because all authority has been utilized, the amount available to discharge amounts coming in course of payment in the following year would automatically be reduced by an equivalent amount. Where there is no appropriation in the subsequent year, alternative arrangements, such as a supplementary appropriation or access to Treasury Board's contingencies vote, would be required.

In our opinion this approach has several advantages:

- the annual accounts can be closed as soon as accounts payable as of March 31 are known;

- the annual accounts are correctly stated and all commitments for which delivery has taken place are recorded in the year's accounts;

- a department is automatically penalized if it exceeds its appropriations;

- it avoids departments rushing to make payments within 30 days where documentation may still not be available;

- it provides a proper legal basis for paying suppliers promptly under the new year's authority without waiting for Supplementary Estimates; and

- it avoids asking Parliament to approve Estimates for which liabilities have already been incurred.

The main disadvantage is that departments may record accounts payable which subsequently do not materialize or which are not properly chargeable to the year's accounts, or alternatively the opposite may occur and all accounts may not be set up as payable.

This danger can be minimized if departments are permitted to set up only accounts payable for specific amounts coming in payment. Normally in these instances there should be purchase orders, receiving slips and other documentation to support the charge. In no cases should unsubstantiated estimates of amounts which are only contingently payable ever be set up. This would have the effect of providing for unforeseen contingencies and should not be permitted.

It is intended that this proposal, as is the case for the present 30-day rule, should apply only to annually lapsing appropriations. Little would be gained in setting up accounts payable for statutory appropriations, particularly those which have the nature of transfer payments.

The intent of these proposals is to produce more accurate program expenditures for each fiscal year, to disclose the amounts of unpaid accounts which departments are carrying into the following year, and to expedite the closing of the year's accounts so that the Public Accounts can be published at an earlier date.

If these proposals are to attain these ends, a time limit must be imposed for recording accounts payable. The time limit might have to vary depending upon the nature of a department's operations and therefore Treasury Board should be authorized by Parliament to set each year's deadlines. In any event, however, it should not exceed the 30 days now allowed to record accounts payable. Accounts payable would normally require adequate documentation to permit authority under Section 27 of the Financial Administration Act to be exercised before the expenditures are recorded. This would include all appropriate coding to ensure the expenditure is properly recorded. Where charges exceed the appropriation authority, payment requisition authority under Section 26 would be exercised only after the new year's authority becomes available.

Where the total amount set up as accounts payable under each vote does not materialize, the balance should be reversed after an appropriate period of time, not to exceed one year, with the credit being to non-tax revenue as a recovery of a prior year's expenditures. Thus, there will be no incentive to overstate accounts payable. Where amounts in excess of the total set up as accounts payable for a vote subsequently turn up, the excess should be recorded as expenditures of the subsequent year, with the totals by votes being disclosed separately in the Public Accounts for that year so that any user can adjust the expenditures between years if this is required.

Under this procedure, Treasury Board should receive periodic reports of expenditures and commitments from each department so that it can monitor departmental expenditures. Particular attention would be

paid to those departments which have overspent the prior year's appropriations or which are forecasting Supplementary Estimates. This is to ensure that they do not escape the sanction of having to cover the prior year's over-expenditures out of the current year's authority. A department can take steps to effect economies over a 12-month period which are not available when over-expenditures come to light only towards the end of a current fiscal year.

It should be noted that this procedure has the effect of making appropriations non-lapsing at the end of the fiscal year to the extent that accounts payable are recorded within the time period allowed, and to the extent that payments are made within the next 12 months. Consideration was given to retaining the 30-day period for making payments to discharge year-end accounts payable, but this would not adequately provide for those situations where vouchers and other documentation are not available within 30 days. Consideration was also given to proposing a period of time for making payment which is longer than the present 30 days, but less than the year provided in the above proposals. This was regarded as an acceptable alternative, but there appeared to be no rationale for a period less than a year other than to force departments to pay their accounts promptly. On balance, it was concluded that the proposals set forth above will impose more rigorous accounting requirements on departments, but will give them greater flexibility as to the timing in which they make payment. Treasury Board should be given authority to specify a period shorter than 12 months for making payment if there is undue delay in settling accounts payable. Treasury Board should also issue regulations prescribing in detail the rules governing the setting up of accounts payable at the year-end, and their subsequent payment.

Recommendation 24 - *The Financial Administration Act should be amended to require all expenditures under annually lapsing appropriations coming in course of payment during*

the fiscal year to be so recorded even if this results in expenditures in excess of the appropriation authority, with disbursements to discharge such accounts being charged against the subsequent year's authority where the current year's authority is exceeded.

Other modifications

Modifications have been made to pure cash accounting in the case of statutory appropriations which provide authority for servicing the government's debt. In this case, interest is accrued for the fiscal year while other debt charges are amortized over five years or over the term of the debt. The practice of accruing interest provides accurate statements of the interest costs incurred in a given year. Therefore we see no reason for changing the practice, although as recommended previously, the practice of amortizing loan flotation costs and premiums should be discontinued.

Salary payments overlapping the year-end are apportioned between the two fiscal years. This is also a non-cash transaction, but it arises only as a result of the government's practice of paying salaries on a bi-weekly basis. It is a sensible modification which avoids complicating administrative procedures and splitting a pay period.

ACCOUNTING FOR COMMITMENTS

Commitment accounting is primarily required in the case of annual appropriations since it is designed to anticipate expenditures coming in course of payment in a fiscal year. However, certain appropriations impose limits on commitments in the current and subsequent fiscal years, in which case the accounting for commitments must cover both current and future years.

The Financial Administration Act, Section 26(3)(c) requires that no payment be made out of an appropriation that would reduce the balance available to an amount insufficient to meet all undischarged commitments. The requirement to certify the availability of funds and maintain commitment records is contained in Section 25, as follows:

> "(1) No contract or other arrangement providing for the payment of money by Her Majesty shall be entered into or have any force or effect unless the deputy head or other person charged with the administration of a service for which there is an appropriation by Parliament or an item included in Estimates then before the House of Commons to which such payment will be charged certifies that there is a sufficient unencumbered balance available out of such appropriation or item to discharge any commitments under such contract or other arrangement that would, under the provisions thereof, come in course of payment during the fiscal year in which the contract or other arrangement was entered into.
>
> (2) The deputy head or other person charged with the administration of a service for which there is an appropriation by Parliament or an item included in Estimates then before the House of Commons shall establish and maintain or cause to be established and maintained on his behalf a record of commitments chargeable to each such appropriation or item in such form as the Treasury Board may prescribe."

Parliamentary control on the basis of each year's appropriations covering all accounts coming in course of payment is less effective if managers do not have a system of commitment control. To ensure that a program is carried on at the level for which funds are voted, potential requirements for funds must be controlled at the earliest possible moment. Decisions which give rise to obligations to make payments during a fiscal year are the events which must be controlled, and the effect of these obligations must be measured in relation to the amounts of expenditure authority granted by Parliament.

A commitment is a financial obligation to make a payment out of annual appropriations. This obligation arises, not out of an intent contained in a manager's mind, but rather when an agreement, legally binding or not, is entered into in good faith with some third party, thereby creating an obligation which must be honoured.

Many departments, however, use their commitment accounting system as a device for earmarking funds where there is an intention to do something, but where there is no obligation to a third party. This gives rise to a degree of uncertainty as to the extent to which commitments are manageable. Therefore, the combination of the two types of commitments is undesirable. Potential commitments, where there is not yet any obligation to third parties, are better recognized separately in budgetary control or cash forecasting systems.

A few departments take an entirely different interpretation of the nature of the requirement imposed by Section 25. These departments interpret that they are satisfying the requirements of the Act when they allot funds to specific responsibility centres. This practice may be effective in preventing over-expenditure of appropriations, but it will not prevent commitments being entered into which would exceed the amount available from appropriations unless each responsibility centre maintains a record of all commitments into which it has entered. Thus, it does not obviate any need to maintain a record of commitments; it only alters the location at which commitment records are kept - for example, at responsibility centres instead of within a central financial division.

It is the nature of some programs that the total amount committed in any year will not, for various reasons, be totally expended in that year. This is where the commitment is dependent upon actions by other parties over which the government may have only limited control. In some instances this has been officially recognized in the Estimates and the commitment authority granted exceeds the amount of the appropriation.

Many other programs have the same problem, but have no formal parliamentary authority to commit more than the amount of their appropriation. To utilize properly the funds at their disposal, these departments have developed a technique of discounting their outstanding commitments so that the net amount does not exceed the appropriation. In fact, this practice is not legal since they are over-committing their appropriations. Where the situation requires over-commitment, it should be specifically authorized in the Estimates.

The Financial Administration Act now refers only to commitments coming in course of payment in the current fiscal year, and thus departments presumably have no authority to enter into commitments payable in future years. A number of departments have had the limits on the total amount of commitments that they may enter into the current year removed by replacing the annual limit with a limit which applies to both the current and subsequent years. These departments contend that where they have this authority they are legally entitled to carry accounts over to the following year since their multi-year commitment authority exempts them from the annual limit imposed by Section 25. The wording of these special appropriation authorities should be revised to ensure that the authority is applicable only to future years and that the current year's limit on transactions coming in course of payment continues to apply. Otherwise these multi-year authorities undermine the ability of the government to ensure that its annual fiscal policy objectives are attained.

To remedy these problems, the following recommendations are proposed.

Recommendation 25 - *For purposes of applying the statutory requirement to maintain a record of commitments:*

- *a commitment should be defined in the Financial Administration Act as an obligation to make payment*

from an appropriation of a current or subsequent year, an obligation which arises when an agreement is made in good faith with other parties;

- *commitments should include:*

  (a) *specific commitments which are discharged as a result of a single action or set of actions, and*

  (b) *continuing commitments which are discharged by a series of actions which are expected to continue for an indeterminate period of time;*

- *intentions to enter into obligations should not be included within the definition of commitments; and*

- *the creation of budgetary sub-allotments should not be regarded as superseding the requirement to keep a record of commitments within each sub-allotment.*

<u>Recommendation 26</u> - *Where there is a significant degree of uncertainty as to whether the other parties will fulfill the conditions necessary for commitments to materialize, and there is a need for commitment authority in excess of the amount of the appropriation, such commitment authority should be provided in the vote wording.*

<u>Recommendation 27</u> - *The practice of imposing constraints through the vote wording on a department's ability to enter into commitments payable in future years should be extended wherever a significant amount of specific commitments payable in future years are normally outstanding,*

but the vote wording should clearly indicate that this does not free the department from the constraint on current year's commitments imposed by the amount of the annual appropriation.

Chapter 8 -

ACCOUNTING FOR FUND APPROPRIATIONS

There are a number of appropriations which authorize amounts to be advanced out of the Consolidated Revenue Fund for purposes of making financial advances, acquiring inventories and facilitating certain manufacturing, trading or service operations. These are accounted for in a different way than the normal budgetary appropriations described in the previous chapter. Such appropriations which are referred to in this chapter as funds or fund appropriations for purposes of simplicity, are listed in Schedule C of the Statement of Assets and Liabilities in Volume I of the Public Accounts. Many terms are used in referring to these funds, including "working capital advance", "revolving fund", "account", and "advance".

There are three main characteristics which distinguish fund appropriations from normal budgetary appropriations:

- net advances under these authorities are designated as non-budgetary and are treated as assets pending recovery or future charge to budgetary expenditures;

- the authority granted by Parliament is continuing and does not lapse at the end of the fiscal year; and

- unlimited authority is provided to utilize receipts for purposes within the ambit of the appropriation.

As a consequence, the accounts presented in the Estimates and Public Accounts differ significantly from those for normal budgetary appropriations.

Treasury Board Circular No. 1970-7 provides the following definition of a fund:

> "A revolving fund or working capital advance is an authorization by Parliament for prescribed purposes to draw from the Consolidated Revenue Fund as working capital, monies not to exceed a given maximum at any one time, which, together with the attendant receipts may be expended for those purposes on a continuing basis. The revolving fund or working capital advance is an authority to draw as required on the Consolidated Revenue Fund, not a segregation of cash."

The circular also defines separately the terms, revolving funds and working capital advances.

As of March 31, 1973, there were 14 revolving funds which were defined in the circular as being used for financing "a specific program or operation of a manufacturing, service or trading nature which is expected to be self-sustaining".

At the same date there were 27 working capital advances used for financing purchases of materials and supplies, imprest cash and bank accounts in remote areas or foreign countries, advances to government employees, production of defence materials and for other purposes of a similar nature.

There were, at the same date, 8 other accounts which were included in Schedule C. These have not been classified by Treasury Board under either of the previous two designations, and are not therefore subject to the rules set forth in the Treasury Board circular.

Exhibit 11 gives a complete list of the three types of funds covered in this section of the report:

EXHIBIT 11

REVOLVING FUNDS

FINANCIAL POSITION AS AT MARCH 31, 1973

(in thousands of dollars)

ASSETS

Name of Fund	Accounts receivable	Inventory	Deferred charges	Capital Assets: Appraisal value	Capital Assets: Cost	Capital Assets: Accumulated depreciation	Capital Assets: Net book value	Total assets
Race Track Supervision (Agriculture)	79	–	–	51	128	(98)	81	160
Government Telecommunications (Communications)	1,795	–	–	–	110	(21)	89	1,884
Passport Office (External Affairs)	30	160	25	50	375	(127)	298	513
Indian Arts and Crafts (Indian Affairs and Northern Development)	111	535	4	–	107	(11)	96	746
Statistics Canada (Industry, Trade and Commerce)	264	–	–	–	–	–	–	264
Expositions (Information Canada)	126	53	–	–	292	(95)	197	376
Photo Centre (National Film Board)	33	71	–	137	79	(43)	173	277
Central Microfilm Unit (Public Archives)	206	15	–	114	20	(58)	76	297
Staff Development and Training (Public Service Commission)	29	–	214	112	166	(124)	154	397
Printing Bureau (Supply and Services)	6,208	2,135	–	2,738	1,248	(1,264)	2,722	11,065
Supply (Supply and Services)	5,327	6,228	39	361	192	(101)	452	12,046
Computer Services Bureau (Supply and Services)	433	19	–	–	234	(136)	98	550
Airports (Transport)	4,483	262	91	113,889	258,564	(21,117)	351,336	356,172
Vetcraft (Veterans Affairs)	–	222	–	–	–	–	–	222
TOTAL	19,124	9,700	373	117,452	261,515	(23,195)	355,772	384,969

FINANCING OF ASSETS

Name of Fund	Accounts payable: Actual	Revolving fund advances: Authorized	Revolving fund advances: Actual	Capital advances: Authorized	Capital advances: Actual	Contributed assets: Actual	Surplus (deficit): Authorized	Surplus (deficit): Actual	Total financing: Actual
			Note 3						
Race Track Supervision (Agriculture)	219	200	(140)*	30	30	51	–	–	160
Government Telecommunications (Communications)	1,540	1,000	141	–	–	99	150	104	1,884
Passport Office (External Affairs)	222	100	(12)*	90	90	213	–	–	513
Indian Arts and Crafts (Indian Affairs and Northern Development)	126	700	458	–	–	469	–	(307)	746
Statistics Canada (Industry, Trade and Commerce)	1,046	250	(782)*	–	–	–	–	–	264
Expositions (Information Canada)	152	1,750	157	–	–	312	–	(245)	376
Photo Centre (National Film Board)	81	450	325	37	37	–	–	(166)	277
Central Microfilm Unit (Public Archives)	154	80	(10)*	–	–	114	Note 2	39	297
Staff Development and Training (Public Service Commission)	165	700	381	40	40	112	150	(301)	397
Printing Bureau (Supply and Services)	3,323	11,000	3,100	–	–	2,795	Note 2	1,847	11,065
Supply (Supply and Services)	4,779	40,000	5,479	85	85	361	Note 2	1,342	12,046
Computer Services Bureau (Supply and Services)	81	2,000	879	88	88	–	–	(498)	550
Airports (Transport)	3,349	3,000	–	292,881	192,379	116,419	Note 1	44,025	356,172
Vetcraft (Veterans Affairs)	–	500	222	–	–	–	–	–	222
TOTAL	15,237	61,730	10,198	293,251	192,749	120,945		45,840	384,969

* Amounts on deposit with the Receiver General for Canada

Note 1: Authorized by Treasury Board to accumulate all surplus for the purposes of acquiring capital assets.
Note 2: Authorized by Treasury Board to accumulate the two best years' surpluses achieved during the previous five years.
Note 3: Seven revolving funds had accumulated moneys for the replacement of capital facilities which moneys have been netted against their advance accounts above

EXHIBIT 11

WORKING CAPITAL ADVANCES

FINANCIAL POSITION AS AT MARCH 31, 1973
(in thousands of dollars)

	Assets				Financing of Assets				
						Working Fund Advances			
Name of Fund	Accounts receivable	Inventory	Advances and loans	Total assets	Accounts payable	Authorized	Actual	Surplus (deficit)	Total assets
Financial advances									
Working Capital Advance (External Affairs)	–	–	1,521	1,521	–	2,100	1,521	–	1,521
Posts Abroad (External Affairs)	–	-	740	740	–	7,000	740	–	740
Audit Services to United Nations	–	–	10	10	–	25	10	–	10
Fire Losses Replacement Account	–	–	–	–	–	5,000	–	–	–
Departmental Field Offices (I T. & C.)	–	–	311	311	–	1,950	311	–	311
Posts Abroad (Manpower and Immigration)	–	–	199	199	–	750	199	–	199
Miscellaneous Departmental Imprest and Standing Advances	–	–	14,003	14,003	–	17,000	14,003	–	14,003
Sub-total	–	–	16,784	16,784	–	33,825	16,784	–	16,784
Financing of inventories									
Agricultural Revolving Fund (Agriculture)	98	544	–	642	156	1,820	486	–	642
Commodities Stabilization Account (Agriculture)	–	–	–	–	–	250,000	–	–	–
Fisheries Prices Support (Environment)	708	357	–	1,065	–	25,000	1,065	–	1,065
Fisheries Working Capital Advance (Environment)	–	8	–	8	–	500	8	–	8
Blank Bonds Reserve (Finance)	–	286	–	286	–	286[1]	286	–	286
Stores Account – National Parks	10	698	–	708	150	1,000	582	(24)*	708
Customs and Excise (National Revenue)	–	113	–	113	–	750	113	–	113
Post Office Revolving Fund	–	773	–	773	10	895	768	(5)*	773
Maritime Marshland Rehab. Admin. Stores (DREE)	–	–	–	–	–	150	–	–	–
Prairie Farm Rehab. Admin. (DREE)	–	185	–	185	–	335	185	–	185
Industries and Stores Account (Pen. Serv.)	125	701	–	826	–	1,000	831	(5)*	826
Livestock and Canning Supplies Stores Account (Pen. Serv.)	14	151	–	165	–	175	165	–	165
Operational Stores Account (Pen. Serv.)	–	2,215	-	2,215	–	3,500	2,215	–	2,215
Canteen Revolving Fund (Pen Serv.)	–	117	–	117	–	255	106	11	117
Construction and Repair Projects (Public Works)	76	–	–	76	–	18,000	76	–	76
Cloth Revolving Fund (RCMP)	–	412	–	412	–	750	412	–	412
Messes Operations Account (RCMP)	57[2]	19	–	76	–	80	76	–	76
Defence Production Revolving Fund (DSS)	24,123	875	7,958	32,956	10,559	100,000	22,401	(4)*	32,956
Stores Account (Transport)	–	9,111	–	9,111	–	13,500	9,111	–	9,111
Hospital Stores Account (Veterans' Affairs)	–	1,740	–	1,740	–	5,000	1,740	–	1,740
Sub-total	25,211	18,305	7,958	51,474	10,875	422,996	40,626	(27)	51,474
GRAND TOTAL	25,211	18,305	24,742	68,258	10,875	456,821	57,410	(27)	68,258

* Shortages pending parliamentary authority to write-off to budgetary appropriation

1 No formal maximum established – actual used for purposes of this schedule
2 Includes cash on hand and in bank of $53 (thousands).

EXHIBIT 11

OTHER ACCOUNTS

FINANCIAL POSITION AS AT MARCH 31, 1973

(in thousands of dollars)

Name of Fund	Assets: Cash	Assets: Inventory	Assets: Accounts receivable, advances, etc.	Assets: Capital assets	Assets: Total assets
Financial advances					
Bullion and coinage (Finance)	–	3,671	–	–	3,671
Gold purchase account (Finance)	–	4,691	–	–	4,691
Miscellaneous accountable advances	–	–	10,884	–	10,884
Sub-total	–	8,362	10,884	–	19,246
Other					
Agricultural Products Board	–	156	–	–	156
Canadian Grain Commission – Canadian Government Elevators	–	–	–	–	–
Stockpiling of uranium concentrates (E.M.R.)	–	101,183	–	–	101,183
Post Office account	–	–	3,703	–	3,703
National Film Board – operating account (Secy. of State)	226	1,327	1,715	3,473	6,741
Sub-total	226	102,666	5,418	3,473	111,783
GRAND TOTAL	226	111,028	16,302	3,473	131,029

Name of Fund	Financing of Assets: Accounts payable	Working Fund Advances: Authorized	Working Fund Advances: Actual	Equity, financed from budgetary expenditures	Total financing
Financial advances					
Bullion and coinage (Finance)	–	*	3,671	–	3,671
Gold purchase account (Finance)	–	*	4,691	–	4,691
Miscellaneous accountable advances	–	*	10,884	–	10,884
Sub-total	–		19,246	–	19,246
Other					
Agricultural Products Board	–	15,000	156	–	156
Canadian Grain Commission – Canadian Government Elevators	–	500	–	–	–
Stockpiling of uranium concentrates	–	135,000	101,183	–	101,183
Post Office account	2,035	*	1,668	–	3,703
National Film Board – operating account (Secy. of State)	3,671	2,550	(403)	3,473	6,741
Sub-total	5,706		102,604	3,743	111,783
GRAND TOTAL	5,706		121,850	3,473	131,029

* No limit established by Parliament

The history of separate funds goes back many years. Several studies, including the Glassco Report, have examined the uses and accounting practices of these funds, and have concluded that they are conducive to good management of the government's resources in certain circumstances. The circumstances in which fund appropriations have been granted are where the operations being financed are either of a suspense or temporary nature in which expenditures will be ultimately recoverable, or else are of a quasi-commercial nature for which government financing, accounting and reporting practices create problems when authorized through normal appropriations.

Managers of fund operations generally favour the arrangement, but many criticisms of present practices have been raised in the Public Accounts Committee and in the reports of the Auditor General. These criticisms have not been directed at the use of funds themselves but rather at their effect on the Statement of Assets and Liabilities of Canada and the divergencies in their manner of parliamentary authorization.

The specific issues raised by the Auditor General and discussed by the Public Accounts Committee include:

- the advisability of retaining surpluses in revolving funds;

- the classification of surpluses when transferred from revolving funds;

- the desirability of acquiring capital assets through loan votes; and

- the practice of financing certain other assets, such as deficits, inventories and accounts receivable, through working capital advances.

In the ensuing sections of this chapter, the following matters are examined:

- the definition and classification of funds;
- the impact of treating advances to funds as non-budgetary rather than budgetary;
- the necessity for the revolving and continuing nature of the authority granted and the limitations on such authorities; and
- accounting and reporting practices.

DEFINITION AND CLASSIFICATION OF FUNDS

There is a good deal of confusion in terminology with regard to these funds. This has arisen because past legislation has associated certain designations with funds, and this has differed from the classification subsequently set forth in the Treasury Board circular where the actual differences are few. Those classified as revolving funds under the Treasury Board circular are required to include operating budgets in the Estimates and to be self-sustaining after covering all costs; these requirements do not apply to working capital advances. This report proposes to eliminate these differences and to treat all types of funds, other than those creating financial claims, in the same manner.

Certain working capital advances are now used to finance advances to employees, and other types of loans. It is proposed that these funds should be redesignated as loan accounts in order to exclude them from the practices proposed in this chapter for what we continue to call fund appropriations. The Defence Production Revolving Fund creates

problems in this regard because it is used both to finance inventories and to finance loans. In the course of implementation, a decision will be required either as to how this Fund should be classified or else to create separate funds for the two purposes.

While the terms "revolving fund", "working capital advance" and "account" may have to be continued because of legal requirements in referring to existing funds, for purposes of future authorization and descriptive headings in the accounts of Canada, we recommend "revolving fund" as a generic term because:

- the term denotes that there is a separate sub-entity in an accounting sense, which is one of the fundamental results of this method of financing;

- the term revolving denotes another fundamental feature of this method of financing, namely that receipts can be used to finance additional expenditures without further authority to spend being required; and

- the term working capital advance, on the other hand, may be mistakenly taken to imply that the fund can be used only to provide for working capital, not fixed capital.

Recommendation 28 - *The present distinction between revolving funds, working capital advances, and similar accounts should be eliminated with the title revolving fund being used in new authorities and where generic headings are required in the accounts of Canada to group all such accounts.*

Recommendation 29 - *Funds used to finance loans or advances outside the defined limits of the Government of Canada should be redesignated as loan accounts.*

THE IMPACT OF TREATING ADVANCES TO FUNDS AS NON-BUDGETARY

An examination of the accounting treatment accorded funds as a result of their present non-budgetary classification, as compared to normal budgetary appropriations, reveals the following:

- advances to funds to acquire inventories, fixed assets and other deferred expenses are carried as assets on the government's Statement of Assets and Liabilities, whereas in budgetary appropriations these types of expenditures would be charged to expenditure. This use to finance expenses that would otherwise be charged to budgetary expenditures has given rise to most of the Auditor General's objections to present practices;

- most funds are included in the Estimates only when additional authority is being requested, whereas budgetary appropriations appears each year whether statutory or to be voted; and

- operating losses are charged as expenditures only when authority is requested to write-off advances to funds, not when the loss is actually incurred as would be true in the case of a budgetary appropriation.

As a result of the recommendations in Chapter 3, fund appropriations will be included in the Estimates with the amounts to be voted being shown separately from estimates of expenditures, but the other differences will remain. The remaining differences can be eliminated if fund appropriations are treated as budgetary, rather than non-budgetary.

This may require some explanation. If fund appropriations are designated as budgetary, amounts expended from the Consolidated Revenue Fund are recorded as expenditures, and receipts are treated as recoveries of expenditures. The net amount advanced will continue to be recorded in the central accounts, but it whould be offset by some means, such as contra accounts, so that the advances do not appear on the Government of Canada's Statement of Assets and Liabilities. The amount of outstanding advances will continue to be recorded as part of the Government of Canada's equity on the Statement of Assets and Liabilities of each individual fund. Where the fund incurs losses to such an extent that repayment of advances is unlikely, the need for the authority for the fund should be re-examined and advances, where appropriate, should be deleted from the accounts of Canada by means of a $1.00 vote in the same manner as other assets are deleted when they are not included on the Statement of Assets and Liabilities of the Government of Canada.

Recommendation 30 - *Appropriations for revolving funds, working capital advances and similar accounts should be classified as budgetary.*

Recommendation 31 - *The net amounts advanced out of the Consolidated Revenue Fund for purposes authorized under fund appropriations should continue to be recorded in the accounts of each fund, until authority is obtained from Parliament to delete all or a portion of the amounts advanced.*

THE JUSTIFICATION FOR REVOLVING AND NON-LAPSING OR CONTINUING AUTHORITIES

In the previous chapter, net and non-lapsing appropriations were generally rejected as undermining parliamentary and fiscal needs. Separate funds combine both of these practices because of the revolving and continuing nature of their authority. Excepting certain operations from normal appropriation practices would appear to be justified only if, over the long run, expenditures are likely to be recovered.

Some illustrations of circumstances where revolving and continuing authorities are appropriate include:

- funds which cover the prefinancing of assets until there is a recovery of expenditures from an appropriation. The best illustration is a fund used to finance inventories;

- funds which cover entire government programs or operations where revenues and expenditures are expected to be sufficient to make the operation fully or partially self-sustaining; and

- funds which cover common service type operations where the purpose is to permit the recovery of costs in full as soon as the services are received by benefitting programs.

The justification for continuing authority is closely related to the justification for a revolving authority. Where expenditures are likely to be recovered, it is not necessarily true that this will take place within a single fiscal period. Thus it makes little sense to

request appropriation authority in years when expenditures exceed revenues, when these are likely to be offset by excess revenues in subsequent years. Although there may be instances where receipts will equal expenditures each year, this is unlikely in the case of most of the uses for which fund appropriations are granted because trading and common service operations require the financing of production, stockpiles of goods, accounts receivable, and other costs until recovered.

An objection to continuing or non-lapsing authority is that it removes operations from annual parliamentary approval and review. This is not true if detailed budgets are submitted for all funds in the Estimates, and their accounts are included in the Public Accounts.

Recommendation 32 - *Where receipts are likely to offset expenditures over the long-term, authority should be granted on a continuing basis, by means of fund appropriations, to make advances from the Consolidated Revenue Fund and to spend receipts.*

NATURE OF OPERATIONS AND COSTS FINANCED BY FUNDS

Exhibit 11, which provided a tabulation of existing revolving funds, working capital advances and accounts, illustrates the wide variety of operations financed through funds. It is important that the purpose of a fund appropriation, like all other appropriations, be stated in terms of distinct objectives which differ from those of other appropriations if parliamentary control is to be truly effective.

This is not now always true. Some funds finance operations closely allied to those financed through annual appropriations. In such cases, the fund should either be wound up or else extended to cover a

clearly defineable segment of a department's operations. In addition, the limits and amounts passing through some funds are so small relative to the budgetary appropriations granted to the same departments that the advantages of the funds in terms of increased financial flexibility do not warrant departing from normal budgetary appropriations.

Until 1970, funds were generally permitted to finance both operating and capital requirements out of a single fund. In 1970, the practice was introduced of financing capital assets used in operations through funds out of separate loan votes, where amounts in addition to those recovered through depreciation were required. This is in contrast to normal appropriations where a separation between current and capital items is not required unless the annual amount of capital expenditures exceeds $5 million.

The separation between amounts advanced for working capital and amounts advanced for capital items results in a complex accounting presentation; it can lead to the situation where capital loans are repaid from the working capital account; and it achieves little that a better Estimates presentation could not also achieve.

A suggested vote wording might be as follows:

> To authorize the operation of a revolving fund in the current and subsequent fiscal years in accordance with terms and conditions approved by the Treasury Board for the purposes of......................, expenditures for working capital, capital equipment and operations to be charged to the fund and amounts recovered to be credited thereto in amounts not greater than the expenditures already charged thereto for each of these types of expenditures; the amount outstanding at any time under this authority not to exceed $X,XXX,XXX.

This wording, it should be noted, provides that receipts can be used only for the types of expenditures from which they are derived.

Later in this section an Estimates table, Exhibit 12, is proposed which displays separately the anticipated cash requirements for operations, working capital and capital items. Each of the amounts forecast could be made the subject of separate allotment control by Treasury Board, or each of these items could be separately incorporated in the appropriation authority. We do not recommend separate limits being imposed on advances for capital, as is the present practice, because this imposes an artificial distinction between assets purchased out of revenues and those purchased out of advances. If a limit is required by Parliament, for example, a limit of $5 million as now required for normal budgetary appropriations, it should be imposed by limiting through the vote wording the amount to be expended on capital in any single fiscal year. In addition, details should be provided on all proposed capital expenditures in excess of $250,000 in the same manner as now required for normal budgetary appropriations.

In summary, the arguments for a revolving fund rest on the need for a combination of continuing authority and authorization to spend receipts.

Recommendation 33 - *Funds should be used in lieu of annual appropriations only where the operations they finance can be clearly distinguished from those financed through other appropriations, and where the magnitude of the operations, relative to the other appropriations of a department, warrant such separate authority.*

Recommendation 34 - *The authority for each fund should cover the financing of working capital, capital and operations, with the wording of the authority imposing a limit on the amount of expenditures for capital purposes in a single fiscal year only in those circumstances where Parliament considers this to be necessary.*

REPORTING PRACTICES

Estimates

All revolving funds, and one of the accounts not designated as a revolving fund, now include operating budgets computed on an accrual basis in the Estimates. No supporting information is provided in the Estimates for the working capital advances, and with the one exception, for the other accounts which are now classified as neither revolving funds nor working capital advances.

It should be emphasized that the recommended presentation is intended to apply to all funds, not just to those that are now designated as revolving funds. Thus, a supporting table will be required in the Estimates for each fund to show expenditures and revenues for the fiscal year, showing separately net amounts to be advanced for operations, working capital, and capital. The illustration in Exhibit 12 suggests a fairly simple presentation which adheres closely to present practices for revolving funds, but which displays cash requirements in a more complete and informative manner.

The benefits of this presentation are that:

- operating results computed on an accrual basis are highlighted;
- the amount of depreciation (i.e. a non-cash charge to operations which is subject to management determination) is separately disclosed;

EXHIBIT 12

ILLUSTRATION OF PROPOSED ESTIMATES PRESENTATION FOR FUND APPROPRIATIONS

ESTIMATES, 1975-76 — MAIN ESTIMATES — *BUDGET DES DÉPENSES 1975-76*

Revolving Fund — Fonds renouvelable

PROGRAM BY ACTIVITIES (thousands of dollars) — *PROGRAMME PAR ACTIVITE (en milliers de dollars)*

Activity – *Activité*	Man-Years Authorized 1975-76 – *Années-hommes autorisees 1975-1976*	EXPENDITURES *DÉPENSES* Estimates 1975/76	Forecast 1974/75	Change	Actual 1973/74	REVENUES *RECETTES* Estimates 1975/76	Forecast 1974/75	Change	Actual 1973/74	EXCESS EXPENDITURES (REVENUES) *DÉPENSES EXCÉDENTAIRES (RECETTES)* Estimates 1975/76	Forecast 1974/75	Change	Actual 1973/74
A		48,000	62,000	(14,000)	30,000	(50,000)	(50,000)	–	(55,000)	(2,000)	12,000	(14,000)	(25,000)
B		33,000	35,000	(2,000)	36,000	(48,000)	(50,000)	2,000	(45,000)	(15,000)	(15,000)	–	(9,000)
C		15,000	15,000	–	17,000	–	–	–	–	15,000	15,000	–	17,000
		96,000	112,000	(16,000)	83,000	(98,000)	(100,000)	2,000	(100,000)	(2,000)	12,000	(14,000)	(17,000)
Less: Depreciation		5,000	5,000	–	5,000	–	–	–	–	5,000	5,000	–	5,000
OPERATING REQUIREMENTS	220	91,000	107,000	(16,000)	78,000	(98,000)	(100,000)	2,000	(100,000)	(7,000)	7,000	(14,000)	(22,000)
CAPITAL REQUIREMENTS		5,000	–	5,000	5,000	–	–	–	–	5,000	–	5,000	5,000
WORKING CAPITAL REQUIREMENTS:													
Increase (decrease)													
Accounts receivable		–	–	–	–	(10,000)	–	(10,000)	–	(10,000)	–	(10,000)	–
Inventories		6,000	5,000	1,000	(2,000)	–	–	–	–	6,000	5,000	1,000	(2,000)
Decrease (increase)													
Accrued liabilities		2,000	8,000	(6,000)	18,000	–	–	–	–	2,000	8,000	(6,000)	18,000
		8,000	13,000	(5,000)	16,000	(10,000)	–	(10,000)	–	(2,000)	13,000	(15,000)	16,000
TOTAL		104,000	120,000	(16,000)	99,000	(108,000)	(100,000)	(8,000)	(100,000)	(4,000)	20,000	(24,000)	(1,000)

ADVANCES AT THE YEAR-END.	Estimates 1975/76	Forecast 1974/75	Change	Actual 1973/74
Authorized	$25,000	$25,000	–	$25,000
Outstanding	20,000	24,000	$4,000	4,000

- the amount of capital expenditures is disclosed, can be supported by a detailed listing of projects in the manner now used for normal capital appropriations, and can be used as the basis for any limit that might be imposed through the vote wording;

- the change in working capital requirements is disclosed in order to adjust operating results computed on an accrual basis to a cash basis; and

- the gross, as well as net, amount to be advanced is presented.

The only other disclosure that would result from this proposal is that the net amounts to be advanced would be carried forward into the Votes and Statutory Authorities table and the General Summary in the column presenting estimates of expenditure. This would clearly distinguish these items as estimates of expenditures, not amounts to be voted. In a case where the cash requirement is negative or represents a net receipt, it would still be shown.

There are two side benefits from the proposed presentation. The amounts of gross expenditures and revenues for the department as a whole would be more accurate and it would enable the standard table showing expenditures by standard objects to be presented to facilitate analysis of all budgetary expenditures by objects of expenditure.

There is one other suggestion for improving the Estimates presentation that should be considered. Since it is proposed that Parliament control funds by limiting the total amount of advances that may be outstanding at any time, it seems reasonable that the authorized limit and the estimated amounts expected to be outstanding should also be disclosed in the Estimates. This is shown on Exhibit 12.

Recommendation 35 - *Estimates of both operating and capital expenditures for each fund should be included in the Estimates as budgetary expenditures supported by a schedule which shows expenditures and revenues from operations, depreciation, capital assets and changes in working capital, and by a note which relates estimated advances outstanding for each of these purposes to the authority limit.*

Public Accounts

The presentation of the detailed accounts of each fund in Volume II of the Public Accounts is now limited to a Statement of Assets and Liabilities, a Statement of Profit and Loss prepared on an accrual basis, and where necessary, a statement reconciling the balance shown as the Government of Canada's advances on the fund's Statement of Assets and Liabilities with that shown on the schedules supporting the Government of Canada's Statement of Assets and Liabilities. Moreover, statements are not submitted for all funds.

This presentation would be improved by the presentation of two additional statements:

- a statement accounting for changes in advances during the year in the same manner as presented in the Estimates; and

- a statement accounting for net expenditures from the Consolidated Revenue Fund during the year by objects of expenditure and by sources of revenue.

Both these statements should show the relationship between amounts included in the Estimates and actual results. Both of these statements should always agree with the amount recorded against the appropriation in the accounts of Canada under the procedure proposed in the next section of this chapter.

Exhibit 13 illustrates suggested formats for financial statements in the Public Accounts. These statements illustrate the effect of some of the recommendations previously put forward. They would be appropriate for all funds, although some minor changes would be required in the case of funds financing inventories.

Recommendation 36 - *The Public Accounts should include the following statements for each fund:*

- *a balance sheet;*

- *a reconciliation of differences, if any, between net amounts advanced from the Consolidated Revenue Fund and net advances as recorded on the statements of the individual funds;*

- *a statement of operations;*

- *a statement of changes in advances which shows operating results, depreciation, expenditures on capital assets, and changes in working capital; and*

- *a statement of gross receipts and expenditures, with expenditures classified by objects and receipts by source;*

the three latter statements showing comparisons with amounts included in Estimates.

EXHIBIT 13

ILLUSTRATION OF PROPOSED PUBLIC ACCOUNTS PRESENTATION FOR FUND APPROPRIATIONS

PUBLIC ACCOUNTS, 1974-75

_______ Revolving Fund
(authorized by Vote ____. Appropriation Act No. ____ 19 __

BALANCE SHEET AS AT MARCH 31, 1975
(with comparative figures at March 31, 1974)
(in thousands of dollars)

ASSETS	1974/75	1973/74
Current assets		
Accounts receivable	5,000	5,000
Inventories, at cost	8,000	3,000
Prepaid expenses and deferred charges	2,000	2,000
Total current assets	15,000	10,000
Fixed assets, at cost	25,000	25,000
Deduct: Accumulated depreciation	10,000	5,000
Net fixed assets	15,000	20,000
	30,000	30,000

LIABILITIES	1974/75	1973/74
Current liabilities		
Accrued liabilities	10,000	18,000
Equity of Canada (authorized advances $25,000,000)		
Advances from Canada —		
Balance beginning of year	5,000	13,000
Advances during year	20,000	(1,000)
	25,000	12,000
Write-off of advances (see note)	—	(7,000)
	25,000	5,000
Surplus (deficit) —		
Balance beginning of year	7,000	(17,000)
Write-off of advances (see note)	—	7,000
	7,000	(10,000)
Net income for the year	(12,000)	17,000
	(5,000)	7,000
	20,000	12,000
	30,000	30,000

Note: Authority to write-off advances of $7,000,000 was provided by Appropriation Act No. ____

Certified correct:

Director, Finance
Approved:

Deputy Minister,
Department of ________

EXHIBIT 13

ILLUSTRATION OF PROPOSED PUBLIC ACCOUNTS PRESENTATION FOR FUND APPROPRIATIONS

Public Accounts, 1974/75

DEPARTMENT OF ______________

__________REVOLVING FUND
STATEMENT OF OPERATIONS
For the year ended March 31, 1974/75
(in thousands of dollars)

	Estimates 1974/75	Actual 1974/75	Actual 1973/74
Sales	100,000	100,000	100,000
Cost of sales	75,000	97,000	68,000
Gross profit	25,000	3,000	32,000
Expenses	10,000	10,000	10,000
Depreciation	5,000	5,000	5,000
	15,000	15,000	15,000
NET INCOME FOR THE YEAR	(10,000)	12,000	(17,000)

DEPARTMENT OF ______________

__________REVOLVING FUND
STATEMENT OF CHANGES IN ADVANCES
For the year ended March 31, 1975
(in thousands of dollars)

	Estimates 1974/75	Actual 1974/75	Actual 1973/74
Net income for the year	(10,000)	12,000	(17,000)
Less: Depreciation	5,000	5,000	5,000
	(15,000)	7,000	(22,000)
Acquisition of capital assets	5,000	–	5,000
Increase (decrease) in working capital:			
Purchase of inventory	(2,000)	5,000	(2,000)
Decrease of accrued liabilities	1,000	8,000	18,000
	(1,000)	13,000	16,000
ADVANCES DURING THE YEAR	(11,000)	20,000	(1,000)

EXHIBIT 13

ILLUSTRATION OF PROPOSED PUBLIC ACCOUNTS PRESENTATION FOR FUND APPROPRIATIONS

Public Accounts, 1974/75

DEPARTMENT OF ____________________

__________ REVOLVING FUND
STATEMENT OF GROSS RECEIPTS AND EXPENDITURE
For the Year Ended March 31, 1975
(in thousands of dollars)

	Estimates 1974/75	Actual 1974/75	Actual 1973/74
Salaries and wages	45,000	42,000	38,000
Transportation and communication	5,000	5,000	4,000
Information	4,000	6,000	1,000
Professional and special services	—	—	1,000
Rentals	7,000	20,000	9,000
Utilities, materials and supplies	7,000	10,000	5,000
All other expenditures	20,000	29,000	25,000
TOTAL EXPENDITURE	88,000	112,000	83,000
Less: Revenue credited to appropriation	99,000	92,000	84,000
TOTAL NET EXPENDITURES	(11,000)	20,000	(1,000)

ACCOUNTING PRACTICES

Costing

The following is a description of some of the more significant practices of funds with respect to the costing of the goods and services they provide:

- revolving funds are required by the Treasury Board circular to account for and pay for all costs of their operations. The only significant exception is that interest is not charged on any assets paid for out of previous budgetary appropriations or on any assets acquired with the proceeds of depreciation;

- working capital advances are required to pay for direct costs only. All forms of indirect and administrative costs are excluded, as well as interest on any advances; and

- other accounts generally pay only for direct costs, but some include memorandum or imputed costs on their financial reports.

The question to be considered is whether all costs should be charged to a fund in all circumstances. There may be need for full costing, for example where the operation is temporary and will be disposed of once it is financially viable, or where the only objective in providing the service is to do so at less cost than would be true if acquired from other sources. Nevertheless, full costs can be disclosed in a notational manner without necessarily being provided for in the appropriation. More importantly, the costs of programs financed through annual appropriations

and funds should be calculated in the same way so that comparisons will be validly made when allocating resources and in aggregating appropriations in the Estimates and Public Accounts. Where a service merely supports other programs, there is little to be gained in recovering costs which the other programs would not have been expected to pay had they provided the service to themselves. In these instances, the pricing policy should be to recover the same costs as are normally charged to all appropriations. Full costing could be misleading and may encourage departments to provide services internally rather than to use a common service agency.

This analysis suggests that there should be a change in the present policy which calls for revolving funds to pay all costs, and working capital advances to pay direct costs only. Decisions on costs should be made in accordance with practices used for normal appropriations and exceptions should be made only where there is some special purpose for obtaining full costs. The previous requirement for a fund to finance all costs becomes less important as a result of the proposal to treat advances as budgetary expenditures.

> Recommendation 37 - *Expenditures to be financed through each fund should be determined in a manner consistent with those used in computing normal appropriations.*

Accrual and modified cash accounting

If the recommendation in this report to treat advances to and from funds as items of budgetary expenditure and revenue is accepted, the question arises as to whether there will be a continuing need for funds to practice accrual accounting.

The main argument for accrual accounting is that it is usually essential to the practice of cost-based accounting which has been defined as "a method of recording transactions so that revenues and expenditures are reflected in the accounts for the period when resources are earned or consumed". Managers of manufacturing or trading operations cannot measure costs and revenues on a month-to-month basis unless they take into account deferred or accrued expenses and revenues. Furthermore, many funds have substantial assets and accrual accounting provides a means of exercising accounting control over such assets.

In order to obtain information from fund accounts that can be aggregated and analysed with other appropriations, information must also be available from their accounts on the modified cash basis normally adhered to by the government. There is also need to account for cash expenditures during the year in terms of objects of expenditure since the government wishes to have this type of detail for purposes of economic analysis.

In order to ensure that the data necessary for aggregating with other appropriations are available in the detail necessary for reconciliation purposes, the following statement should be provided monthly by each fund:

<u>Receipts</u>	$	<u>Payments</u>	$
Operating receipts		Operating expenditures	
Receipts from sales of capital assets (specify)		Capital expenditures (specify)	
Other receipts		Additions to inventories	
Increase in advances		Other payments	
		Reduction of advances	

It should be noted that in the supplementary period after the year-end, the monthly statement would record accounts receivable from other departments, and all accounts payable in view of the proposal in the following section which discusses year-end procedures.

The cash data on the 12 monthly cash statements and the accrual data for the supplementary period will provide the data necessary to prepare and verify the Statement of Expenditure and Revenue and the Statement of Changes in Advances illustrated in Exhibit 13. These latter statements match the form of the Estimates presentation and explain the changes in advances, as well as disclosing separately transactions not affecting advances, such as depreciation and working capital balances other than accounts payable and those accounts receivable transactions which are recorded in the central accounts.

Recommendation 38 - *Each fund should keep its accounts:*

- *on an accrual basis so that expenditures can be related to revenues and assets made subject to good accounting control; and*

- *on a modified cash basis so that information equivalent to that required of other appropriations can be obtained for purposes of aggregation and analysis with the other accounts of Canada.*

Year-end procedures

The timing of the "cut-off" of cash transactions by separate funds has no effect on their operating results, which are recorded on an accrual basis. However, as a result of proposals in this report to

treat funds as budgetary, it is necessary that the method of computing the amount of advances during the year be consistent for operations financed both through funds and through annual appropriations if the government's budgetary surplus deficit is to be consistently determined. This means that accounts due at the year-end should be set up as accounts payable on the Statement of Assets and Liabilities of the Government of Canada and the amounts recorded as advances to the fund increased correspondingly. If this practice is followed the net amounts advanced during the year and shown as budgetary expenditures in the appropriation accounts will be computed in a manner consistent with other appropriations. This will permit comparisons with the limits on advances provided in the fund authority to be computed as if all accounts payable had been settled by cash payments.

Some funds accept advance payments from departments which are financed out of annually lapsing appropriations. This practice should be prohibited since it is obviously a device to get around the general intent that these annual authorities should lapse unless effective delivery has taken place prior to the fiscal year-end.

> Recommendation 39 - *The year-end procedures for accounting for amounts advanced during the year to funds should be applied in the same manner as for other budgetary appropriations and should include amounts required to discharge debts payable for work performed, goods received or services rendered prior to the end of the fiscal year.*

IMPACT OF RECOMMENDATIONS

The use of fund authorities has been dealt with in this chapter extensively because use of funds involves a number of fairly significant departures from traditional methods of granting parliamentary

authority. A number of these departures has been questioned in the reports of the Auditor General of Canada and it is believed that the proposals in this report will resolve them.

- Retention of surpluses in revolving funds to cushion the impact of subsequent losses no longer will have any significance in terms of the budgetary accounts since the budgetary accounts are charged with cash advances and credited with reimbursements. While the accumulated surpluses will continue to be identified in a notational manner, under the vote wording suggested, they will not add to the authority granted to the fund to finance capital and working capital.

- Classification of surpluses is no longer an issue since excess revenues would be included in the Estimates and Public Accounts as refunds of expenditures.

- Capital assets would no longer be indirectly recognized as assets of Canada when they are financed through funds if advances are treated as budgetary.

- Deficits, inventories and other assets, would no longer show as assets of Canada.

As a result of proposals put forward, for operations financed through fund authorities:

- all expenditures out of the Consolidated Revenue Fund would be accounted for as budgetary expenditures;

- all receipts credited to the Consolidated Revenue Fund, up to the limits of expenditures charged thereto, would be netted against budgetary expenditures;

- year-end procedures would be the same as for other appropriations; and

- additions to their spending authorities through retained profits and any other credits not offset by previous disbursements would not be permitted.

The funds would differ from normal appropriations only in the authority granted to spend revenues and in the continuing nature of the authority granted.

The effect of these proposals would be that those departments having working capital advances for the purpose of financing small amounts of stores would have little incentive to continue their use since the same results would be attained by accounting for changes in inventories within their normal appropriations. Those operations that are of a quasi-commercial nature or are common services would have continued advantages to derive from fund authorities because of the multi-year flexibility and the authority to use revenue which is inherent in the fund type of appropriations.

Chapter 9 -

ACCOUNTING FOR GOVERNMENT ENTERPRISES

This section of the report is primarily concerned with Crown corporations listed in Schedules C and D of the Financial Administration Act. Schedule B Crown corporations, having been previously defined as part of the Government of Canada accounting entity, are not included in this chapter on government enterprises. The section concludes by referring to those other Crown corporations which are not included in the Schedules to the Act.

The treatment of Crown corporations in the accounts of Canada may be briefly outlined. The loans to, and investments in, Crown corporations are carried at cost on the Statement of Assets and Liabilities, with those whose recovery is likely to require parliamentary appropriations being shown separately. The amounts invested in each corporation in terms of capital stock, advances, loans, etc. are disclosed in a supporting schedule. In addition, a supplementary statement in Volume I of the Public Accounts discloses the total government equity in these corporations as shown by their financial statements as compared to the values carried on the Statement of Assets and Liabilities. Audited financial statements of most Crown corporations are presented in Volume III of the Public Accounts, although some are included in Volume II.

The Government of Canada does not consolidate the accounts of these Crown corporations with its own accounts. Dividends paid to the government are recorded as revenue when received. Consolidation would be difficult in practice, even if it were warranted in principle, because the Crown corporations normally use commercial or enterprise accounting principles which differ significantly from those used for the accounts of Canada. Moreover, Crown corporations often have different fiscal year-ends, and would have difficulty in arriving at a cut-off of transactions at the government's fiscal year-end, which would eliminate

transactions and outstanding balances between the government and its Crown corporations. Even if consolidation were technically feasible, its desirability would be doubtful because the consolidation would be made up of widely diverse operations and the result would be little more than an arithmetic compilation.

While it would be much simpler technically to practice equity accounting, and each year record any change in the government's equity in Crown corporations, there are several arguments for not doing so:

- the equity will often be represented by assets such as fixed assets, inventories, accounts receivable, etc. which the government does not normally report in its statements;

- the increased equity will seldom represent a financial claim by the government which can be exercised, without adverse impact on the corporation, to generate cash for use in discharging financial obligations; and

- many corporations carry on operations which are in the nature of commercial enterprises and which are better accounted for separately from governmental operations.

This report therefore rejects these alternatives and recommends continuation of the present method of accounting for government enterprises in the financial statements of the Government of Canada. This chapter is mainly confined to examining budgeting and financial reporting practices of Crown corporations listed in Schedules C and D to determine whether their accounts, as separately kept, satisfy the requirements of Parliament and other users.

DEFINITION AND CLASSIFICATION OF CROWN CORPORATIONS IN FINANCIAL ADMINISTRATION ACT

The Financial Administration Act defines a Crown corporation as:

> "a corporation that is ultimately accountable, through a Minister, to Parliament for the conduct of its affairs, and includes the corporations named in Schedule B, Schedule C and Schedule D".

The Act permits the Governor in Council to transfer a corporation from one schedule to another.

The categories included in Schedules B, C and D are described respectively as follows in the Financial Administration Act:

- departmental - "any Crown corporation that is a servant or agent of Her Majesty in right of Canada and is responsible for administrative, supervisory or regulatory services of a governmental nature";

- agency - "any Crown corporation that is an agent of Her Majesty in the right of Canada and is responsible for the management of trading or service operations on a quasi-commercial basis, or for the management of procurement, construction or disposal activities on behalf of Her Majesty in right of Canada"; and

- proprietary - "any Crown corporation that

  i) is responsible for the management of lending or financial operations, or for the management of commercial and industrial operations involving the production of or dealing in goods and the supplying of services to the public; and

ii) is ordinarily required to conduct its operations without appropriations".

"Departmental corporations" are in effect treated as departments for purposes of the Financial Administration Act.

Under the provisions of the Financial Administration Act agency corporations are required to submit their operating budgets annually for approval; proprietary corporations are not required to do so, presumably because they require a greater measure of operating freedom. The Act also makes agency corporations subject to regulations in respect of contracts. Another distinction occurs outside the Financial Administration Act; the Income Tax Act stipulates that proprietary corporations listed as such in the Financial Administration Act are subject to income tax. Thus, the present classification of corporations into agency and proprietary corporations serves solely in respect of budget submissions, contractual commitments and liability for income tax. The distinction has no relevance from the point of view of financial reporting, since both are required to submit the same basic statements.

CROWN CORPORATION BUDGETS

The Financial Administration Act makes reference to two types of budgets - operating and capital. Proprietary corporations are required to submit capital budgets annually, while agency corporations are required to submit annually both capital and operating budgets.

The particular sub-sections of the Financial Administration Act concerning Crown corporation budgets are noted below:

70(1) "Each agency corporation shall annually submit to the appropriate Minister an operating budget for the next following financial year of the corporation for the approval of the appropriate Minister and the President of the Treasury Board."

70(2) "For each corporation, the appropriate Minister shall annually lay before Parliament the capital budget for its financial year approved by the Governor in Council on the recommendation of the appropriate Minister, the President of the Treasury Board and the Minister of Finance."

70(3) "The Treasury Board, on the joint recommendation of the President of the Treasury Board and the appropriate Minister, may by regulation prescribe the form in which budgets required by this section shall be prepared."

The statutes of a few Crown corporations contain provisions for submission of budgets, and where this is true the provisions of the specific statute prevail.

Operating budgets require the approval of the appropriate minister and of the President of the Treasury Board and are clearly an internal government control mechanism exercised by the Treasury Board and the appropriate minister concerned.

Capital budgets, when submitted for approval by the Governor in Council, are first reviewed by a Cabinet Committee and subsequently by Cabinet. This practice is of considerable significance since it enables the government to ensure that a corporation's proposals are consistent with government policy. These budgets are laid before Parliament after approval by the Governor in Council. They serve not only as a public announcement of what is contemplated by the corporations, but also as an appropriate control procedure.

Operating budgets are needed covering a fiscal period which is reconcilable with that of the Government of Canada and displaying revenues separately from expenditures. Prepared on an accrual basis, they should be adjusted for non-cash items to arrive at net cash requirements. Details in terms of the amounts anticipated from the government as well as amounts expected to be paid over to the government should be shown.

In the case of capital budgets there should be requirements for a five-year forecast. Commitments outstanding at the beginning of the budget period should be detailed as well as those to be made in the ensuing year. Cash expenditures should be shown in terms of total estimated cost, amounts spent to date, amounts to be spent in the current year, and amounts to be spent in subsequent years. Details of capital expenditures in terms of such uses as fixed assets, increases in working capital, loan repayments, dividends, and other such items should be disclosed along with sources of financing. Such detail should include sources such as: profits from operations, disposal of fixed assets, share issue, decrease in working capital and borrowing.

The provision of the Financial Administration Act whereby the Treasury Board "on the joint recommendation of the President of the Treasury Board and the appropriate Minister, may by regulation prescribe the form in which budgets...shall be prepared" presents several difficulties in improving present practices. Firstly, it seems to envisage a regulation comprising a separate budget format for each individual corporation, or alternately, a regulation which has the endorsement of all ministers responsible for corporations. This inhibits the making of regulations where uniformity or consistency among the corporations is desirable. Secondly, since the President of the Treasury Board may not be able, on his own, to initiate a regulation, it may be difficult to upgrade and improve budget submissions. Thirdly, a regulation dealing only with the form of budgets is too restrictive unless it also covers the contents of the budget and the basis on which it should be prepared (e.g. cash basis versus accrual).

The status of an approved budget is not clear; from time to time the question is raised as to what the Governor in Council is being asked to approve when presented with a particular budget. While there is a general consensus as to what is meant by an approved budget, the Financial Administration Act or regulations issued thereunder should stipulate that approval of a capital budget extends only to approval in

principle of the projects or categories shown therein, the commitments associated with them, and the cash expenditures (ceilings) shown for the budget year, subject to funds becoming available as indicated in the budget. The Act should also stipulate that approval of an operating budget extends only to the cash expenditures shown for the budget year, subject to cash receipts being generated as indicated in the budget.

Recommendation 40 - *The Financial Administration Act should be amended to authorize the Governor in Council on the recommendation of the Treasury Board to prescribe for Crown corporations classified under Schedules C and D:*

- *definitions of each type of budget to be submitted;*

- *the format, content, period and basis of preparation of each type of budget as well as the manner and timing of submissions;*

- *conditions for the submission of revised budgets; and*

- *conditions, governing the approval of a capital budget, which provide only for approval in principle of the projects or categories shown therein, the commitments associated with them, and the cash expenditure ceilings shown for the budget year, and which stipulate that approval in principle of the level of spending of budgets is conditional upon funds becoming available as indicated in the budget.*

CROWN CORPORATION FINANCIAL STATEMENTS

Part VIII of the Financial Administration Act contains several provisions on the keeping of accounts by Crown corporations and on the preparation and submission of statements and reports. These provisions

apply only to Schedule C and D corporations. Where an agency or proprietary corporation is incorporated by a special statute and the special statute has provisions relating to accounts and reports, the corresponding Financial Administration Act provisions do not apply.

The Financial Administration Act, Section 75, requires the Crown corporations to produce annually a balance sheet, a statement of income and expense, and a statement of surplus which are in such form as the Treasury Board prescribes and which conform to the requirements set out in the Canada Corporations Act for annual reports to shareholders. These statements "shall also include such other financial information as the appropriate Minister, the Treasury Board, or the Minister of Finance may require". In addition, there are provisions in the Financial Administration Act relating to the creation of reserves and the preparation of such other financial reports as Treasury Board may require. However, Treasury Board has not issued any regulations as to the form of Crown corporations financial statements or the creation of reserves.

The Canada Corporations Act has a number of provisions which relate to the keeping of books and accounts, the form and substance of financial statements including a statement of source and application of funds, definitions and other aspects, such as subsidiary accounting. While the provisions are, to a great extent, specific in nature, some of them make reference to "generally accepted accounting principles" which allude to those recommended by the Canadian Institute of Chartered Accountants and which are generally accepted by the courts.

Any examination of the accounts of Crown corporations must proceed from the premise that the accounts of Crown corporations are intended primarily to ensure accountability to Parliament and to serve as an effective means of communication to Parliament, the government and the people of Canada. To accomplish this intent, the accounts should produce, to the extent feasible, the information which all interested parties require to comprehend and make decisions on government activities.

In recognition of this, the financial statements of Crown corporations should clearly display certain financial transactions between the government on the one hand and the corporations on the other, as well as the manner in which parliamentary authorizations have been exercised. Where aggregate data on the Crown corporations might be usefully compiled, such information should be consistently displayed in individual financial statements.

Examination of the published accounts of Crown corporations reveals:

- some corporations consolidate all subsidiaries, others some subsidiaries, and others no subsidiaries;

- all of the Crown corporations prepare their financial statements on an accrual basis;

- all corporations prepare balance sheets and operating or income statements. About half of them prepare a statement of source and application of funds. With respect to surplus or retained earnings, about one-third of the corporations prepare a separate statement to show changes in the year; others incorporate such details into the appropriate portion of the balance sheet;

- except where special statutes dictate the need for special statements, the concept of program accountability is not always followed. In one instance, although there was a special vote to cover certain annual deficits, it was not possible to discern from published statements, the details of the subsidized services provided;

- most corporations which receive deficit subsidies reflect them in their financial statements, but deficit subsidies paid by government to one corporation are not reflected in its published financial statements. The expenses related to the subsidy are excluded as is the subsidy. Several corporations receive special operating grants or subsidies, other than deficit subsidies, but the disclosure of them is not consistent. Grants are reflected either in the revenue portion of the income statement or as a deduction from expenses. Not all corporations which receive interest from government disclose the amount in their income statements;

- with one exception, all corporations having loans from government identify them as such on their balance sheets. Some corporations distinguish between those government loans due within a year and those due within a longer period; other corporations do not make this distinction. In some instances it is not possible to distinguish between loans payable to government on demand and those payable over a specified term. In the case of loans payable to the private sector, it is not always discernible whether such loans are guaranteed by the federal government;

- contingent liabilities are not always adequately disclosed. This shortcoming occurs primarily in respect to guarantees given by the corporation as well as major forward commitments and other obligations;

- the equity sections of the balance sheets of Crown corporations are not consistent in format and content and sometimes are not in accordance with accepted accounting principles. These sections are variously labelled by the corporations as "shareholders' equity", "proprietary equity",

"equity of Canada", "proprietary equity of Canada", "equity available for future operations", "capital", etc. There is also inconsistency in the elements included in the equity section. On some balance sheets, government loans are included; in others they appear in the liabilities section, similar to the practice of corporations in the private sector;

- by generally-accepted accounting principles the surplus portion of a balance sheet should distinguish between retained earnings and contributed surplus, but the presentation in the statements of Crown corporations is also somewhat inconsistent in this respect;

- corporations have adopted a variety of financial year-ends which means that anyone wishing to consolidate information in respect of corporations would have difficulty in doing so.

While corporations can have considerable freedom in the manner in which they conduct their affairs, this should not prevent corporations being required to publish financial information in a consistent manner. In the private sector this is one of the purposes of corporate legislation, such as the Canada Corporations Act, and generally-accepted accounting principles. In recognition of the fact that emphasis is on accountability, financial statements should adequately disclose cash transactions which occur between the corporation and the government, particularly in a way which relates the transactions to specific parliamentary authorizations and government programs. Displaying information in this manner would also serve the needs of economic and financial analysts in identifying cash flows between the government and the private sector, as opposed to transactions within government itself.

Notwithstanding that balance sheets and statements of income and expenditures of Crown corporations are prepared on an accrual basis, information on a cash basis of accounting can be provided by means of a statement of source and application of funds.

Because of the diversity of activities and programs, producing consolidated financial statements of government and the corporations would be complex and inadvisable. Nevertheless it is possible to have all Crown corporations reflect certain details (e.g. cash balances, marketable securities, loans payable) on a uniform basis to facilitate summarization of these items individually, after eliminating internal transactions.

In summary, the review of Crown corporation financial statements reveals that there are four basic problems: statements are prepared at variance with generally-accepted accounting principles; there is a lack of consistency, statements do not display separately transactions between the corporation and the government; and there is not always adequate disclosure. These point to the need for guidelines to be issued to corporations for preparing financial statements.

At present, published financial statements of the Crown corporations are prepared on an annual basis. Parliament is in a position to give close scrutiny to the statements of a corporation only once a year, and therefore annual production of statements for such scrutiny is quite adequate. Nevertheless there is public interest in the current operations of Crown corporations and quarterly statements should be published.

To review the operations of government as a whole (including Crown corporations) over a 12-month period, a complication arises as a result of diverse year-ends. While the government's year-end is March 31st, many corporations have year-ends which are different. Understandably, it is not desirable to require all corporations to use March 31st. Nevertheless publication of statements on a fixed quarterly basis (March 31st, June 30th, September 30th, December 31st) would facilitate a reasonably accurate consolidation of government activities during a given quarter and at the government's fiscal year-end.

Recommendation 41 - *The Financial Administration Act should be amended so that regulations may be issued in respect of the accounts and financial statements of Schedule C and D Crown corporations and subsidiaries thereof providing for:*

- *separate disclosure on financial statements for each area of program accountability and for each parliamentary authorization;*
- *disclosure of transactions between the government and a corporation and between government-owned corporations, arising from grants, contributions, loans, interest and similar transactions;*
- *issue of a statement of source and application of funds;*
- *issue of quarterly interim statements;*
- *creation of reserves; and*
- *such other matters as are required for purposes of consistent and adequate disclosure of their financial affairs.*

CORPORATIONS NOT SCHEDULED IN FINANCIAL ADMINISTRATION ACT

This report has not attempted to question the existing definition and classification of Crown corporations since we considered this to be beyond our terms of reference. Nevertheless, our terms of reference do require us to comment on the completeness of the accounts of Canada.

There are a few Crown corporations which report to Parliament through a Minister but which are not included in Schedules B, C and D. Because of the special character of these few Crown corporations, Recommendations 40 and 41 do not apply to them. In our view, however, it is desirable that the statements of these corporations, as now published in accordance with their own legislation or any other pertinent legislation, should be included in Volume III of the Public Accounts of Canada.